Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
High-Cost Universal Service Support	)	WC Docket No. 05-337
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Lifeline and Link Up	)	WC Docket No. 03-109
	)	
Universal Service Contribution Methodology	)	WC Docket No. 06-122
	)	
Numbering Resource Optimization	)	CC Docket No. 99-200
	)	
Implementation of the Local Competition	)	
Provisions in the Telecommunications Act of	)	CC Docket No. 96-98
1996	)	
	)	
Developing a Unified Intercarrier	)	CC Docket No. 01-92
Compensation Regime	)	
	)	
Intercarrier Compensation for ISP-Bound	)	CC Docket No. 99-68
Traffic	)	
	)	
IP-Enabled Services	)	WC Docket No. 04-36

COMMENTS OF
THE NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES, MAINE OFFICE OF PUBLIC ADVOCATE, MARYLAND OFFICE OF PEOPLES' COUNSEL, THE UTILITY REFORM NETWORK, AND THE UTILITY CONSUMER ACTION NETWORK
ON FURTHER NOTICE OF PROPOSED RULEMAKING

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I. INTRODUCTION AND SUMMARY

On November 5, 2008, after what can perhaps best (or at least charitably) be described as a tumultuous four months of back-and-forth wrangling over the interconnected issues of intercarrier compensation ("ICC") and the federal universal service fund ("USF"),[1] the Federal

[1] Given the multiplicity of dockets involved here -- both those specified in the caption and those addressed in related filings -- references to those dockets will be, as follows, e.g., *In the Matter of Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92 will be to

(continued….)

Communications Commission ("FCC" or Commission") released a document designated as a combined "Order on Remand and Report and Order and Further Notice of Proposed Rulemaking" in the above-captioned dockets.[2] The Order on Remand represented the Commission's response to the writ of mandamus granted by the United States Court of Appeals for the District of Columbia Circuit directing the Commission to respond, before November 5, 2008, to the Court's remand of the Commission's intercarrier compensation rules for Internet Service Provider ("ISP")-bound traffic.[3]

There was no reason why this order could not have been issued on its own. Nonetheless, the Commission included with the Order on Remand a Report and Order ("R&O") that in one paragraph -- actually in one sentence -- rejected, without explanation, the comprehensive recommendations of the Federal-State Joint Board on Universal Service ("Universal Service Joint Board") released November 20, 2007.[4] All the FCC had to say was,

> [W]e appreciate the great efforts expended by the Joint Board and its staff in considering how best to reform the current high-cost support mechanism and in developing its recommendations. We choose not to implement the recommendations contained in the *Comprehensive Reform Recommended Decision* at this time, however.[5]

This brush-off can only be viewed as an insult to the Joint Board. It is hard to understand how the FCC Commissioners who are members of the Joint Board -- who were part of the unanimous support on the Joint Board for the *Comprehensive Reform Recommended Decision* -- could have approved of this language.

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"01-92". The immediate opening salvo in the current tumult came with the filing in 01-92, et al. by AT&T Inc. ("AT&T") on July 17, 2008 of a three piece ex parte communication, which included a "Petition for Interim Declaratory Ruling and Limited Waivers Regarding Access Charges and the 'ESP Exemption'", which within the week was docketed as WC Docket No. 08-152 and put out for public comment (see Public Notice, DA 08-1725, released on July 24, 2008) and two letters. The first letter discussed the comprehensive ICC reform referred to in the Petition, and urged the Commission "to act decisively to unify terminating intercarrier rates for all carriers." AT&T cover letter (July 17, 2008) at 1. The second letter urged "the Commission to formally extend the preemptive effect of the Vonage Order to fixed location VoIP services, such as AT&T's U-verse VoIP." Cover letter at 2.

[2] FCC 08-262 ("08-262").

[3] *In re Core Communications, Inc.*, 531 F.3d 849, 861-62 (D.C. Cir. 2008) (directing the Commission to respond to the remand in the form of a final, appealable order explaining its legal authority to issue the pricing rules for ISP-bound traffic adopted in the 2001 *ISP Remand Order*). That Order was issued in *Intercarrier Compensation for ISP-Bound Traffic*, CC Docket Nos. 96-98, 99-68, Order on Remand and Report and Order, 16 FCC Rcd 9151 (2001) ("*ISP Remand Order*"), *remanded but not vacated by WorldCom, Inc. v. FCC*, 288 F.3d 429, 432 (D.C. Cir. 2002). The Order on Remand occupies ¶¶ 1-29 of FCC 08-262.

[4] 05-337, 96-45, Recommended Decision, 22 FCC Rcd 20477 (JB 2007) ("*Comprehensive Reform Recommended Decision*").

[5] 08-262, ¶ 37.

The third piece of 08-262 is the Further Notice of Proposed Rulemaking ("FNPRM"),[6] to which these comments respond. The FNPRM seeks comment on

> three specific proposals. The first, attached as Appendix A, is the Chairman's Draft Proposal circulated to the Commission on October 15, 2008, which was placed on the Commission's agenda for a vote on November 4, 2008. This item subsequently was removed from the Agenda on November 3, 2008. The second, attached as Appendix B, is a Narrow Universal Service Reform Proposal circulated to the Commission on October 31, 2008. The third, attached as Appendix C, is a draft Alternative Proposal first circulated by the Chairman on the evening of November 5, 2008. Appendix C incorporates changes proposed in the *ex parte* presentations attached as Appendix D.[7]

In addition, the FNPRM seeks

> particular comment on two questions. First, should the additional cost standard utilized under § 252(d)(2) of the Act be: (i) the existing [total element long-run incremental cost] TELRIC standard; or (ii) the incremental cost standard described in the draft order? Second, should the terminating rate for all § 251(b)(5) traffic be set as: (i) a single, statewide rate; or (ii) a single rate per operating company?[8]

The Chairman's Draft Proposal (Appendix A of 08-262), as it will be referred to herein, is 158 pages long. The Narrow Universal Service Reform Proposal ("Narrow Proposal") is 42 pages.[9] And the Alternative Proposal (as it will be referred to herein) is 157 pages.[10]

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[6] The FNPRM represents ¶¶ 38-41 of 08-262, and four appendices.

[7] 08-262, ¶ 40 (footnote omitted). It is not explained why the changes proposed in these three specific ex partes from these three specific groups were added to the last-minute Alternative Proposal.

[8] Id., ¶ 41.

[9] The primary features of the Narrow Proposal are 1) a cap on the high-cost fund (Narrow Proposal, ¶¶ 14-18), which it has in common with the Chairman's Draft Proposal; 2) the move to a reverse auction process for all support (id., ¶¶ 18-38), which goes beyond what is in the Chairman's Draft Proposal; and 3) the adoption of a numbers-based USF contribution mechanism for residential customers and a connections-based mechanism for business customers (id., ¶¶ 39-104), which also goes beyond what is in the Chairman's Draft Proposal. In these comments, the issue of a global auction process is discussed briefly in the relevant section (VI.G.) addressing the reverse auctions proposal in the Chairman's Draft Proposal; the issue of the connections-based mechanism is also discussed briefly in the relevant section (X.) concerning the Chairman's Draft Proposal.

[10] According to the FNPRM, the Alternative Proposal "incorporates changes proposed in the *ex parte* presentations attached as Appendix D." FNPRM, ¶ 40. Those ex partes propose many changes, **not all of which are incorporated into the Alternative Proposal**, and none of which are specifically flagged. We have identified two specific changes from the Chairman's Draft Proposal: 1) A total phase-out of CETC support, with another FNPRM seeking "comment on an appropriate universal service mechanism (or mechanisms) focused on the deployment and maintenance of advanced mobile wireless services in high-cost and rural areas" (Additional

(continued….)

Incredibly, despite the volume and number of issues encompassed in the three proposals,[11] and despite the fact that the release of 08-262 on November 5, 2008 was the first time that much of the detail and reasoning behind the Chairman's Draft Proposal was made public, parties were given only 14 days after Federal Register publication to file comments. That publication occurred on November 12, 2008.[12] Thus the numerous stakeholders will have had all of three weeks to comment on these extremely broad proposals and, adding injury to injury, will have only seven days in which to reply to the many varied comments likely to be filed. It is difficult to see how this process will lead to any ability of the Commission to resolve these difficult issues on a rational basis.[13]

In the face of these circumstances, the National Association of State Utility Consumer Advocates ("NASUCA"),[14] whose members and the consumers they represent are vitally interested in these issues, are perplexed as to the most effective course of action.[15] We lack the resources of many in the industry, who are able to deluge the dockets with filings and to haunt the halls of the FCC.[16] Yet the consumer interests represented by NASUCA's members deserve full and careful consideration by the Commission in its quest for decisions that are in the **public** interest.

To that end, NASUCA provides here comments principally on the major themes embodied in the Chairman's Draft Proposal, with some discussion of the Narrow Proposal and the Alternative Proposal. When possible, the comments will cite to and incorporate prior comments and ex partes on these subjects, rather than repeat the earlier arguments. And the order of discussion

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Proposal, ¶ 52); and 2) unconditional supplemental USF for rate-of-return carriers to make up for lost access charge revenues (id., ¶¶ 320-321). We decline to comment on the former as unjustified and possibly unlawful; comment on the latter can be found in the relevant section (IV.) on the Chairman's Draft Proposal.

[11] Admittedly, some of the proposals have aspects that are duplicative.

[12] 73 Federal Register 219 at 66821; see http://edocket.access.gpo.gov/2008/pdf/E8-26849.pdf.

[13] Perhaps, as discussed later, a summary rejection would be appropriate, unlike the undeserved summary rejection of the *Comprehensive Reform Recommended Decision*.

[14] NASUCA is a voluntary, national association of consumer advocates in more than forty states and the District of Columbia, organized in 1979. NASUCA's members are designated by the laws of their respective states to represent the interests of utility consumers before state and federal regulators and in the courts. *See, e.g.*, Ohio Rev. Code Chapter 4911; 71 Pa. Cons. Stat. Ann. § 309-4(a); Md. Pub. Util. Code Ann. § 2-205(b); Minn. Stat. Ann. Subdiv. 6; D.C. Code Ann. § 34-804(d). Members operate independently from state utility commissions, as advocates primarily for residential ratepayers. Some NASUCA member offices are separately established advocate organizations while others are divisions of larger state agencies (*e.g.*, the state Attorney General's office). Associate and affiliate NASUCA members also serve utility consumers, but have not been created by state law or do not have statewide authority.

[15] NASUCA and its members have been active participants in these issues, filing comments and ex partes in most of these dockets.

[16] A number of parties have taken advantage of the ex parte process to communicate their views on parts of the proposals to the Commission even before the comment dates here.

attempts to place related issues together, which is not necessarily the case with any of the three proposals.[17]

NASUCA's goal, like the Commission's, is to increase the efficiency of the ICC system. But we seek to do so without extreme measures that sacrifice equity for efficiency and that radically restructure the system. We also seek to increase the efficiency and the effectiveness of the USF system, while keeping in mind the statutory goals of that system, again without radical change.

We will begin with the ICC-related proposals. This includes the proposals to set a uniform and unified ICC rate, based on a new pricing model, and in the process preempting state authority over intrastate access. By and large, although NASUCA does not oppose, indeed supports, the idea of reducing the variance in current ICC rates among services and jurisdictions, we do reject the means by which the FCC is seeking to achieve that end. We also note that despite these tremendous decreases in access charges (and other ICC), there is no requirement that the carriers who will enjoy those savings pass them through to their customers. Certainly, the access charge reductions seen in recent years -- both on the interstate and intrastate levels -- have not resulted in customer savings on long distance.

The Chairman's Draft Proposal then provides for recovery of revenues lost to carriers as a result of the reduced ICC rates. The first source to be tapped for recovery is increases to the interstate subscriber line charge ("SLC"). NASUCA emphatically opposes this proposal, for a wide variety of reasons discussed herein. The Chairman's Draft Proposal then addresses revenue recovery through the federal USF high-cost fund. But the proposals here are much more limited than those for the SLC. Thus NASUCA's opposition to the proposals is tentative, and may be alleviated. NASUCA does appreciate, however, the recognition in the Chairman's Draft Proposal that carriers have other means for revenue recovery than just the SLC and the USF.[18]

The Chairman's Draft Proposal also addresses phantom traffic. NASUCA supports those efforts.

Then there are the USF issues that at base have little to do with ICC. First among those is the proposal to condition receipt of high-cost funds by carriers on their extending the availability of broadband service to 100% of each of their study areas within five years. Although NASUCA has long supported expansion of broadband service, it appears that the focus of this proposal on making broadband a condition of high-cost support carriers is misplaced; there is a significant risk that the condition will not address the real problem of non-rural carriers' failing to deploy broadband in the rural portions of their territories.

Likewise, although NASUCA appreciates the sentiment behind the proposal to include broadband as a supported service for Lifeline customers, in this area as in many others the devil is in the details.[19] And there is not enough detail in the proposal to merit more than a qualified endorsement; NASUCA proposes additional details.

[17] These comments have benefited substantially from the work of Dr. Robert Loube, who contributed to the discussion of protocol conversion, the incremental cost test, incentives to states to reduce intrastate access charges, and broadband deployment. Dr. Loube's work on this project was funded by the Maine Office of Public Advocate, the Maryland Office of People's Counsel, The Utility Reform Network, and the Utility Consumers' Action Network.

[18] Chairman's Draft Proposal, ¶ 313.

[19] Which, of course, was one of the difficulties many parties had with responding to the Chairman's Draft Proposal when it was first circulated: The details had not been publicly revealed.

Then there is the proposal to place a cap on the entire high-cost fund at December 2008 levels. Here again, although NASUCA supported an interim cap on high-cost fund disbursements to competitive eligible telecommunications carriers ("CETCs"), the notion of a permanent cap on the fund raises questions about how the Commission could find a capped fund to be "sufficient" for USF purposes, as directed by 47 U.S.C. § 254(b)(5).

On the other hand, NASUCA supports the Commission's determination to eliminate the identical support rule for CETCs. This is a position NASUCA has consistently taken.

And last but not least, there is the portion of the Chairman's Draft Proposal that would replace the current revenue-based USF contribution mechanism for residential customers with a numbers-based mechanism. NASUCA has shown over and over again that there is no need for such a change; the lack of need is especially signaled by the recent announcement that the revenues-based mechanism will likely significantly decrease for the first quarter of 2009. In the face of this lack of need, the move to a hybrid mechanism -- numbers-based for residential customers, and revenues-based for non-residential customers -- makes even less sense.[20]

Despite its apparent intentions to be a global high-cost USF resolution, there are many pieces of the USF conundrum that are missing from the Chairman's Draft Proposal. Prime among these are the remand from the Qwest case regarding the high-cost funding for non-rural carriers, and the similar but not identical issues for rural carriers. There are also issues regarding the granularity of support, and the use of outdated cost models to calculate the level of support. It is simply unreasonable to assume that these issues have gone away.

It also appears that the Chairman's Draft Proposal attempts to solve ICC and USF problems by placing pieces of the puzzle on the table and moving them around to have it appear that they cover the field. But that will not work: Universal service is not a two-dimensional issue with discrete pieces; rather, it, like the networks the USF supports, is an interconnected web of relationships. Push in one place, and somewhere else something pushes out; pull on one string, and something else collapses.

One would hope that these ideas were at the forefront of the thoughts of Commissioners Adelstein, Copps, McDowell and Tate when they drafted their joint statement issued with the release of 08-262. The four Commissioners said,

> [W]e do believe that there is a tentative but growing measure of consensus on a number of issues, including: moving intrastate access rates to interstate access levels over a reasonable period of time; not unduly burdening consumers with increases in their rates untethered to reductions in access charges; addressing phantom traffic and traffic stimulation; implementing an alternative cost recovery mechanism in certain circumstances; eliminating the identical support rule and moving over time towards support based on a company's own costs; emphasizing the importance of broadband to the future of universal service; and clarifying the implementation of the Alaska Native regions and tribal lands exception to the CETC cap adopted on May 1, 2008, and the need for special consideration for such areas.

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[20] If the Commission does adopt a numbers-based mechanism, however, NASUCA strongly supports the proposals to exempt Lifeline customers from the assessment (especially because Lifeline SLCs are currently exempt) and to exempt free stand-alone voice mail services such as those provided by Community Voice Mail National from the numbers-based assessment.

If the Chairman's Draft Proposal is examined in this light, it fails to meet **any** of the criteria identified by the other Commissioners, except perhaps eliminating the identical support rule and addressing phantom traffic.

NASUCA's comments address the elements of the three proposals individually. Some of the elements are positive; much more of the proposals are deeply objectionable. We do not view any of the proposals as an indivisible package; neither should the Commission.

II. THE COMMISSION SHOULD NOT ADOPT THE CHAIRMAN'S DRAFT PROPOSAL ON INTERCARRIER COMPENSATION RATES.

The Chairman's Draft Proposal describes a "new approach" to ICC.[21] The approach asserts that all intercarrier traffic – interstate and intrastate access, and reciprocal compensation – should be governed by 47 U.S.C. § 251(b)(5), and that the Commission should prescribe a ratemaking formula for ICC for all this traffic.

The new approach includes

> a ten-year transition plan. In the first stage, intrastate access rates are reduced to the levels of interstate rates. During stage two, carriers will reduce their rates to an interim uniform termination rate, set by the state. Carriers whose current rates are below the interim uniform rate set by the state, however, may not increase their rates. During stage three, the rates carriers charge at the end of stage two (either the interim uniform rates or their prior rates, whichever are lower) will be gradually reduced to the rates that will apply at the end of the transition. This transition will be designed by the state so as to minimize market disruptions and adverse economic effects.[22]

The first stage will last two years, with a 50% reduction in the excess of intrastate access over interstate within the first year, and the remaining 50% eliminated by the end of the second year.[23] The second stage will apparently last two years, with year-by-year reductions in all charges to a "state-wide interim, uniform reciprocal compensation rate applicable to all carriers"[24] that will be based on the new incremental cost standard.[25]

This is where things become unclear. Paragraph 194 refers to "the end of ten years (i.e., at the end of stage two)," but also refers to "stage three -- a six-year gradual downward transition to the final uniform reciprocal compensation rate, which the states will also set, consistent with the methodology we adopt in this order." It is also unclear what the difference will be between the "interim" rate and the "final" rate, given that they will be determined under the same methodology. Paragraph 194 also refers to a "glide path" from the interim rate to the final rate, but it is not clear whether the glide path is to be identical for each carrier within a state. These uncertainties are grounds for not adopting the proposal.

[21] Chairman's Draft Proposal, ¶ 190.
[22] Id., ¶ 192.
[23] Id., ¶ 193.
[24] Id., ¶ 194.
[25] Id., ¶¶ 262-275.

The most fundamental objections to this proposal are first, the preemption of state authority over intrastate access charges, and second, the methodology that the FCC prescribes for the statewide uniform rate.[26] These are addressed below.

A. THE COMMISSION SHOULD NOT PREEMPT THE STATES ON INTRASTATE INTERCARRIER COMPENSATION

As noted above, the publication of the Chairman's Draft Proposal was the first opportunity for parties to review the legal rationale for, among other things, the proposal to preempt state authority over the methodology for setting intrastate access charges. This is provided in ¶¶ 215-227 of the Chairman's Draft Proposal. Without the time to dissect the reasoning in detail, it will have to suffice to refer to the NARUC ex parte filed on October 28, 2008 in many of these dockets. In that ex parte (at 5-7), NARUC provides plenty of reasons why the states continue to have jurisdiction over intrastate ICC.[27]

That being said, another part of the Chairman's Draft Proposal will likely have a significant impact on intrastate ICC. In ¶ 209, the Chairman's Draft Proposal states,

> We now classify as "information services" those services that originate calls on IP networks and terminate them on circuit-switched networks, or conversely that originate calls on circuit-switched networks and terminate them on IP networks (collectively "IP/PSTN" services). Such traffic today involves a net protocol conversion between end-users, and thus constitutes an "enhanced" or "information service."

What is not stated is that such "information services" may not be required to pay ICC, whether access or reciprocal compensation. The provision of the Act under which the Chairman's Draft Proposal would take control of all ICC is 47 U.S.C. § 251(b)(5), which imposes a duty "to establish reciprocal compensation arrangements for the transport and termination of **telecommunications**"; 47 U.S.C. 252(d) sets the principles for traffic covered by 251(b)(5), which principles the Chairman's Draft Proposal purports to follow. Although in a footnote the Chairman's Draft Proposal explains that information services are provided "via telecommunications,"[28] which would allow IP/PSTN traffic to be within the 251(b)(5) framework, and that the Commission has ancillary authority under 47 U.S.C. § 201 to require the imposition of ICC on such information services, that reasoning may not be strong enough to withstand appeal.[29] In any event, the crucial issue of whether all such traffic will be required to pay ICC -- whether access (intrastate or interstate) or reciprocal compensation -- is not explicitly resolved.

In response to the Chairman's Draft Proposal, NASUCA asserts that the Commission should not classify as "information services" those services that originate calls on IP networks and terminate

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[26] Although the Chairman's Draft Proposal asserts that it does "not set forth a methodology that states must use in setting the interim, uniform reciprocal compensation rates" (id., ¶ 195), the only methodology referred to for setting those rates is the incremental cost test.

[27] More generally on applying 47 U.S.C. § 251(b)(5) to all traffic, see 05-337, et al. Embarq ex parte (October 28, 2008) at 3-4; 01-92, Broadview Networks, et al. ex parte (October 23, 2008).

[28] Id., n.564.

[29] See also 01-92, et al., tw telecom inc. et al. ex parte (October 23, 2008); 05-337, et al. Embarq ex parte (October 28, 2008) at 4-5.

them on circuit-switched networks, or conversely that originate calls on circuit-switched networks and terminate them on IP networks. Protocol conversions are part and parcel of any telecommunications network. To begin a telephone call, a sound wave must be converted to an electronic wave. Within most telephone calls, analog electronic waves are converted to digital signals. In some cases, the digital electronic signals are converted to light signals and back again into electronic signals. These conversions do not change telecommunications services into information services. Similarly, the protocol conversion to Internet Protocol does not create an information service. Rather, protocol conversions conducted for the "management, control or operations of a telecommunications system or the management of a telecommunications service"[30] are necessary components of the provision of telecommunications services.

Further, although the Chairman's Draft Proposal does not explicitly address so-called "IP-in-the-middle" traffic, the message is clear: In order to evade state jurisdiction, carriers will increasingly move their traffic so as to meet the criteria in the Chairman's Draft Proposal, if it were to be adopted.[31] That would leave all regulation of such traffic to the FCC, which will not be good for the consumers of those services.

Even if the Commission were correct in asserting that it had the authority to preempt state authority over intrastate charges (if it were **able** to do so), this does not mean that such an action **should** be taken. That goes to the details of the preemption, and based on those details -- chief among them the adoption of an incremental cost standard for this traffic -- the Commission should not do so.

B. THE COMMISSION SHOULD NOT ADOPT THE INCREMENTAL-COST TEST.

The Chairman's Draft Proposal adopts a uniform costing standard for all ICC, that being "incremental cost."[32] This standard would replace the current total element long run incremental cost ("TELRIC") standard that has applied to reciprocal compensation since the time of the *Local Competition First Report and Order* issued in 1996.[33]

The proposed incremental-cost standard for determining intercarrier compensation rates is unreasonable, unfair and inconsistent with competitive market practices. One of the goals of utility ratemaking is to establish rates that mirror the rates that would be set in a competitive market. The proposed rule is, ostensibly, an attempt to achieve this goal. The proposed rule relies on the standard criterion for economic efficiency, that price should be set equal to the marginal cost of producing the service or commodity.

But the general rule that price should equal marginal cost is reasonable for industries that produce single products or multiple products with separable cost functions and where incremental cost is positively related to the quantity produced. **These conditions do not exist in the telephone industry.** Instead, the telephone industry is characterized by firms that have

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[30] 47 U.S.C. 153(20).

[31] See Chairman's Draft Proposal, ¶ 211.

[32] Id., ¶ 236.

[33] *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 and Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, CC Docket Nos. 96-98, 95-185, First Report and Order, 11 FCC Rcd 15499 at 15515, 15844-96, ¶¶ 29, 672-732 (1996) (subsequent history omitted) ("*Local Competition First Report and Order*").

relatively high network costs, non-separable cost functions, extremely low and declining incremental service cost, and a large proportion of costs as common costs. In such circumstances, it is not possible to set all prices equal to incremental cost. For example, one leading economist has stated,

> [M]any important industries involve technologies that exhibit increasing returns to scale, large fixed and sunk costs, and significant economies of scope. Two important examples of such industries are telecommunications services and information services. In each of these cases the relevant technologies involve high fixed costs, significant joint costs and low, or even zero, marginal costs. Setting prices equal to marginal cost will generally not recoup sufficient revenues to cover the fixed cost and the standard economic recommendation of 'price at marginal cost' is not economically viable.[34]

Other leading analysts have stated that:

> Since marginal cost is the added (variable) cost incurred by the supply of one additional unit of output, then by definition marginal costs does not include fixed or sunk costs, because neither of these costs is variable. Hence, a price equal to marginal cost covers only variable and makes absolutely no contribution to recovery of either fixed or sunk costs. Such a price clearly is a recipe for insolvency."[35]

Those analysts further stated that if a firm decided to price all goods at marginal cost, it would be committing "voluntary suicide."[36]

These conclusions, while stated in terms of "marginal" cost, are not impacted by the use of marginal cost versus an "incremental" cost standard, or a short-run versus a long-run cost approach. Rather, they are dependent on existence of substantial common costs.

The Commission has long recognized that telecommunications networks are characterized by relatively high common costs. For example, the Commission stated that "the costs of local loops and their associated line cards in local switches, for example, are common with respect to interstate access service and local exchange service, because once these are installed to provide one service they are able to provide the other at no additional cost."[37] The Chairman's Draft Proposal recognizes the existence of these relatively high common costs when it states:

> For example, a copper loop can be used to provide analog voice service as well as data service using DSL technology. The cost of the loop is therefore common to both voice and DSL services. The incremental cost of voice service, assuming that DSL is already provided, therefore does not include any of the long run

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[34] Hal Varian, Differential Pricing and Efficiency, First Monday (1996), available at http://www.firmonday.dk/issues/issue2/different; also quoted in the direct testimony of Dr. Jeffrey A. Eisenbach on behalf of Verizon Maryland in the Maryland Public Service Commission, Case No. 9133, filed July 8, 2008

[35] William J. Baumol and Daniel G. Swanson, The New Economy and Ubiquitous Competitive Price Discrimination: Identifying Defensible Criteria of Market Power, 70 Antitrust Law Journal, 2003, page 5.

[36] Id.

[37] *Local Competition First Report and Order*, ¶ 678.

> incremental cost of the loop itself. Similarly, the incremental cost of DSL, assuming voice is already provided, includes only that portion that may be required to condition the loop to meet the higher quality standards that may be required for the data transmission.[38]

If the Commission believes that it is appropriate to use its incremental-cost standard to set regulated rates, then the rates for subscriber line charges ("SLCs") would decrease to a number approaching zero. Moreover, if rates for intercarrier services and SLCs are both set using the incremental-cost standard, then every carrier would face mandated rather than voluntary suicide. Given the impossibility of applying the incremental-cost standard to every rate, it is necessary to determine why it should be applied to any rate. Clearly, it is necessary for the carrier to recover its common costs in order to maintain financial viability. The proposed incremental-cost standard mandates that common costs are recovered from all other services and not from intercarrier services. One defense for such a rule is that it is better to recover costs from your own customers than from other carriers. This argument ignores the fact that other carriers are also "customers." They are simply wholesale customers rather than retail customers. Wholesale customers use facilities and equipment just like retail customers.

There is no economic theory that supports price discrimination in favor of wholesale customers over retail customers, especially with regard to recovery of common costs. The implication of driving wholesale prices toward zero is meaningless for industries such as the steel industry where almost every sale is wholesale to an automobile company or a construction company or an appliance company. This designation of good and bad customers to charge places an entirely new slant on the saying "I can get it for you wholesale" because getting it for wholesale is getting the service almost free.

In addition, it is asserted that it is necessary to reduce the intercarrier rate to the incremental-cost standard in order to eliminate the opportunities for regulatory arbitrage associated with ISP and CLEC strategies. The Chairman's Draft Proposal notes that TELRIC-based reciprocal compensation rates led certain carriers to design their

> business plans to take advantage of above-cost reciprocal compensation payments by becoming a net recipient of local traffic. The most prevalent example of regulatory arbitrage for reciprocal compensation is ISP-bound traffic where the Commission found evidence that "CLECs appear to have targeted customers that primarily or solely receive traffic, particularly ISPs, in order to become net recipients" of reciprocal compensation payments."[39]

The ISP strategy generates profits for an ISP and CLEC when the ISP locates in or near the central office of the CLEC. The ISP receives significantly more terminating traffic than originating, allowing the CLEC to earn substantial profits based on receiving more reciprocal compensation from the ILEC than it pays to the ILEC. However, this strategy relies on dial-up Internet traffic that no longer exists.[40] The majority of Internet users have switched to DSL or

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[38] Further Notice of Proposed Rulemaking, Appendix A, ¶ 247.

[39] Chairman's Draft Proposal, ¶ 239, quoting *Intercarrier Compensation NPRM*, 16 FCC Rcd at 9616, ¶ 11.

[40] Except for many rural carriers. See 01-92, et al., CenturyTel ex parte (September 19, 2008) at 7.

cable modem service. Many of the dial-up ISPs went bankrupt and no longer exist. This market is now too small to have a significant impact on the industry.

The other CLEC strategy was for each CLEC to establish its own terminating rate for interexchange access. The CLEC could maintain excessive terminating charges because if a interexchange carrier wished to complete a call to a CLEC's customers it had to pay the terminating charge to the CLEC. However, the Commission eliminated this abuse of terminating monopoly power by requiring CLECs to charge terminating access charges that are no higher than the ILEC in whose territory the CLEC was operating. Thus, it is no longer necessary to reduce the intercarrier rate to incremental cost to offset any regulatory arbitrage strategy conducted by a CLEC alone or by a CLEC in conjunction with an ISP.

Of course, the desire to become a net recipient of traffic depends on the reciprocal compensation rate being above the recipient carrier's cost -- and in many cases the CLECs' rates were based on the ILECs' costs. And the ILECs wanted to ensure that their reciprocal compensation rates were high, **in order to avoid the situation where CLECs would dump traffic onto the ILECs' networks.**[41]

It makes no sense to apply the incremental-cost standard just to termination and transport of traffic under 47 U.S.C. 251(b)(5). But if the standard were applied to other access charges, such as subscriber line charges and special access services, or to other wholesale rates, or to retail rates, this would lead to carrier bankruptcies. Instead, any costing standard adopted by the Commission must allow for a reasonable recovery of common cost from all customer groups -- both retail and wholesale, and both end-users and carriers.

The current TELRIC standard meets that goal and should be applied not only to intercarrier services but also to SLC charges. That is, SLC charges should be no higher than the current SLC cap or twenty-five percent of the sum of the TELRIC loop and port rates. Even though it has been shown that it is unnecessary and capricious to set the intercarrier rate equal to the incremental-cost standard, it is still necessary to develop a reasonable pricing rule that allows carriers to recover their common costs. NASUCA asserts that using the TELRIC standard for setting federal access rates including the SLC is a reasonable way to recover both incremental and common cost.

Further, the Ramsey rule,[42] the alternative most often suggested by other economists as a mechanism to recover common costs, is unworkable and unreasonable in this context. The Ramsey rule is a pricing scheme that seeks to minimize the deviation from the alleged optimal solution that price equals incremental cost. In practice, the scheme is simplified to the inverse elasticity rule. This rule asserts that prices should be inversely proportional to elasticity of demand. Prices will be high in inelastic markets and services, and low in very elastic markets and services. Normally, economists claim that because residential demand for telephone service

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[41] Indeed, that was the reason behind the ILECs' strong original opposition to bill-and-keep mechanisms.

[42] Baumol, W.J. and D. Bradford, Optimal departures from marginal cost pricing. American Economic Review 60 (1970), pages 265-283; Taylor, W.E., Rebuttal testimony, prepared on behalf of Verizon New England, Investigation by the Department of Telecommunications and Energy on its own motion into the appropriate regulatory plan to succeed price cap regulation for Verizon New England's intrastate retail telecommunications services in the Commonwealth of Massachusetts, (September 18, 2002).

is relatively inelastic, the economically efficient result is to raise residential rates significantly above the incremental cost of residential service.[43]

Applying Ramsey pricing, however, is not a simple task. "To set prices correctly at Ramsey levels one requires current and accurate information on demand elasticities. But, in practice, such data are so difficult to obtain that the literature offers what may be described as a few display examples."[44] Moreover, given that alternatives are appearing for ILEC service, the elasticity of demand for ILEC residential service should be increasing. On the other hand, because the carrier is required to deliver calls to other carriers, the elasticity associated with intercarrier access and reciprocal compensation rates must remain very low. Thus, the Ramsey rule would imply high mark-ups above incremental cost for intercarrier service rates, rather than the zero mark-up proposed in the Chairman's Draft Proposal.

Moreover, when services are complements, the simple inverse elasticity rule cannot be applied. In such instances, the Ramsey rule compensates for the cross-elasticities among services. The cross-elasticity impact would imply that basic service, such as residential exchange, be sold below rather than above incremental cost because it is necessary to price in such a manner to acquire customers.[45] Once the carrier has the customer, it will be able to sell other commodities, such as Call Waiting, above incremental cost to cover the loss on the basic service and recover the common costs. This strategy is also used by competitive wireless carriers. Those carriers sell cellular phones below cost in order to acquire customers. The customers purchase bundles of usage along with the cellular phone. The revenue associated with the bundles of usage allows the wireless carrier to recover the loss associated with the sale of the cellular phone, other common costs and the incremental cost of usage. Therefore, the logical consequence of a sophisticated interpretation of the Ramsey rule would lead to **reductions** in SLC rates and to **high** margins on intercarrier services, and a practical review of wireless carrier practices suggests the same outcome. These outcomes confirm the assertion that the incremental-cost standard is unreasonable and inconsistent with competitive market activity, and should not be applied to ICC.

An alternative theoretical approach based on club theory leads to a similar conclusion that SLC rates should be reduced and usage rates increased. The SLC is the equivalent of an option to use the facilities of a club. It does not directly purchase any services. It is the equivalent of membership fee. The usage rate allows a consumer to use the facilities of the club. Club theory shows that as competition increases, the membership fee decreases, and the usage fee approaches a competitive norm. Thus, the membership fee, or SLC, is a measure of the monopoly power of the firm.[46]

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[43] Taylor, W.E. (2002).

[44] Baumol, W.J., Economically defensible access pricing, competition and the preservation of socially desirable cross-subsidy. Utilities Policy 10 (2001), pages 151-159.

[45] Webb, G.K., The Economics of Cable Television. Lexington Books (1983), page 110. See also J. Tirole, The Theory of Industrial Organization, MIT Press (1998), page 70 ("An interesting phenomenon that may arise with complements is that one or several of the goods may be sold below marginal cost …so as to raise the demand for other goods sufficiently.").

[46] S.Scotchmer, "Two-tier pricing of shared facilities in a free-entry equilibrium," Rand Journal of Economics, Vol. 16, No. 4, Winter 1985, page 468.

This review of the proposed incremental-cost standard and other cost/rate theories highlights the fact that the incremental-cost standard is an extreme proposal. It is inconsistent with competitive outcomes. It is not required to prevent regulatory arbitrage. And it requires high rates for other services in order to allow the carrier to recover common costs.

The review of other pricing standards, the sophisticated Ramsey rule or club theory, suggests that SLC rates should be substantially reduced either to below incremental cost or to approach zero. On the other hand, retention of the TELRIC standard for intercarrier rates and applying that standard to SLC rates is a practical outcome, is free from controversies associated with the proper interpretation of the rule, allows the recovery of common costs, provides for stable rates, is fair to all classes of customers, and avoids undue discrimination. Thus, using the TELRIC standard establishes just and reasonable rates, is consistent with competitive outcomes and is consistent generally accepted ratemaking principles.[47]

The ILECs have also consistently argued that TELRIC costing yielded rates that were too low, allowing the use of their network elements at "subsidized" rates.[48] If the ILECs were correct, then the Chairman's Draft Proposal compounds that problem by forcing rates even lower and creating an even greater subsidy. Importantly, the crucial difference between TELRIC and the incremental-cost standard proposed by the Chairman's Draft Proposal is that the incremental-cost standard includes none of the joint or common costs of the firm.[49]

The Chairman's Draft Proposal adopts the incremental-cost standard only for intercarrier compensation, leaving TELRIC as the cost standard in place for all of the other rates required by 47 USC § 251. The rationale is that "excessive" reciprocal compensation rates allowed carriers to game the system.[50] Yet as explained above, this was an artifact of the ratesetting process rather than a flaw of the standard under which the rates were set. And the other reason is that TELRIC, but not incremental cost, includes joint and common costs.[51] Thus using incremental cost allows intercarrier services to avoid absorbing any of those costs, without justification.

It should be recalled that the Faulhaber paper on which the Chairman's Draft Proposal relies was intended to identify the situation where a product or service was being subsidized: If it was priced below incremental cost, then it was being subsidized.[52] A firm that provides all of its services at incremental costs would not recover any of its joint or common costs, and would (presumably quickly) go out of business. And if a service is priced at incremental cost, this means that one or more of the firm's other services must make the contribution to joint and common costs that the incremental-cost-priced service would otherwise be making.[53]

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[47] J. C. Bonbright, Principles of Public Utility Rates (1961), page 291.

[48] See, e.g., *Verizon Communications v. FCC*, 535 U.S. 467, 498, 501-504 (2002).

[49] Chairman's Draft Proposal, ¶ 251.

[50] Id., ¶ 265.

[51] Id., ¶ 266.

[52] Correspondingly, according to Faulhaber, it can only be definitively said that a service is providing a subsidy when it is priced above its stand-alone cost.

[53] See 01-92, Broadview Networks, et al. ex parte (October 27, 2008) at 2-3 (quoting RBOC condemnations of incremental cost pricing).

The FNPRM specifically asks for comment on two questions: whether incremental cost or TELRIC should be the standard[54]; and whether there should be a single, statewide rate or a single rate per operating company.[55] NASUCA's position on the first question should be clear:

[54] FNPRM, ¶ 41.
[55] Id.

TELRIC is the proper standard for intercarrier rates.[56]

As to the second question, on the assumption that the reference to "operating company" refers to individual operating companies in each state (rather than across holding companies), then the issue boils down to whether a carrier's rate is supposed to reflect that carrier's cost. Only by combining or ignoring individual carrier's individual costs is it possible to adopt a uniform statewide rate. Here again, a deviation from the Commission's finding that § 251 rates should be based on each carrier's individual costs is not justified.

C. THE COMMISSION SHOULD ADOPT A SEPARATE STANDARD FOR RURAL CARRIERS.

Along those lines, the Commission should continue to recognize the significant and substantial differences between the largest non-rural carriers and the smaller rural carriers. In this context, the Commission should adopt the current interstate access rates for rural carriers as the intercarrier compensation rates for all types of interstate traffic originating from and terminating at rural carriers.

The Commission's goal of mitigating arbitrage opportunities can be met by establishing one rate for interstate traffic originating from and terminating at a rural carrier. The arbitrage opportunities are associated with different rates for the same service provided by the same carrier. The opportunities are not linked to the level of that rate and are not linked to the fact that one carrier's rates are different from another carrier's rates. Thus there is no requirement to reduce all carriers' rates to one very low level in order to prevent arbitrage. In addition, many rural carriers have similar rates because the carriers are members of the National Exchange Carrier Association ("NECA") pool. Allowing the NECA pool to continue would maintain the current rate similarity, and would also maintain the low level of administrative costs placed on the rural carriers.

Moreover, adopting the current rate levels would eliminate the need to increase the SLC for rural carriers. Adopting the current rate levels would also eliminate any request for revenue replacement funding because the carriers' revenues would not be affected by the Commission action. Thus, it would not be necessary to increase the ICLS and IAS mechanisms by $500 million to replace revenue losses, as indicated in the Alternative Proposal.

D. THE COMMISSION SHOULD PROVIDE INCENTIVES FOR THE REDUCTION OF INTRASTATE ACCESS CHARGES.

The Chairman's Draft Proposal preempts state authority over intrastate access charges. As shown above, that is beyond the Commission's powers.

But the Commission should not ignore the problems created by the disparity between interstate access and intrastate access. In addition to establishing one rate for all interstate intercarrier compensate rates, it is clear that one rate for all services including intrastate services would further mitigate arbitrage opportunities. Rather than preempting, the Commission should provide the states an incentive to voluntarily reduce state access rates to the interstate access levels. The incentive provided to the state commission should be sub-divided into two parts -- one part designed to reduce the non-rural price-cap carriers' state access rates and the second part designed to reduce the rural carriers' state access rates.

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[56] Reply comments in the Commission's investigation into changes to the TELRIC standard were filed almost five years ago. See WC Docket 03-173.

With regard to non-rural price-cap carriers' state access rates, the Commission should offer to reduce the SLC to its TELRIC equivalent in any UNE zone where the SLC is above the TELRIC-equivalent and retain the current SLC caps for all other zones if the state commission requires non-rural price-cap carriers to set their state access rates equal to their interstate access rates. The TELRIC equivalent of the SLC is 25 percent of the TELRIC loop rate and the frozen Dial Equipment Minute interstate percentage times the TELRIC port rate. It is necessary to multiply the TELRIC rates by this percentage because TELRIC rates are determined on a total pre-separations basis and SLCs are determined on a post-separations basis. Because the Commission already gathers the TELRIC loop and port rates as part of its Interstate Access Support ("IAS") mechanism, the Commission would be able to immediately provide state commissions with the TELRIC equivalent rates by carrier by UNE zone.

With regard to rural rate-of-return carriers, the Commission should offer to provide revenue re-balancing support to carriers if the state commissions require these carriers to reduce their state access to the current interstate access rates. The rebalancing support would be calculated as the difference between the current state rates and the current interstate access rates times the current year state access minutes. This rebalancing support differs from the approach taken in the Alternative Proposal because it does not protect rural carriers from market forces that may or may not be reducing rural carrier lines and minutes. Thus, it provides an incentive for the rural carriers to promote usage on their facilities and to retain customers. Unlike the Alternative Proposal, it does not allow the rural carriers to sit back and clip universal service coupons. In addition, rural price-cap carriers should be allowed to make a one time election to revert to rate-of-return regulation and participate in this program.

III. THE COMMISSION SHOULD NOT INCREASE THE SLC AS A MEANS OF LOST ACCESS CHARGE REVENUE RECOVERY.

The *CALLS Order* led to increased SLCs (for residential customers, from $3.50 to $6.50) as a means of allowing recovery of revenues lost when interstate access charges were reduced.[57] The Missoula Plan would have increased SLCs up to $10, for the same reason.[58]

In that light, perhaps consumers are supposed to be happy because the Chairman's Draft Proposal would only increase the SLC cap for residential and single-line business lines from $6.50 to $8.00, the non-primary residential line SLC cap from $7.00 to only $8.50, and the multi-line business SLC cap from $9.20 to only $11.50.[59] But both the rationale for the recovery and the method of recovery are fundamentally wrong.

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[57] *In the Matter of Access Charge Reform*, CC Docket No. 96-262, et al., Sixth Report and Order, et al., FCC 00-193, 15 FCC Rcd 12962 (2000) ("*CALLS Order*") ("CALLS" stood for the so-called Coalition for Affordable Local and Long distance Service.) The *MAG Order* accomplished the same thing for rate-of-return carriers. *In the Matter of Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, *et al.*, Second Report and Order, *et al.* FCC 01-304, 16 FCC Rcd 19613 (2001) ("*MAG Order*").

[58] 01-92, ex parte communication (July 24, 2006) from the NARUC Task Force on Intercarrier Compensation ("NARUC Task Force"), with "Missoula Plan" attached, at 4.

[59] Chairman's Draft Proposal, ¶ 298.

The representation is made that the SLC increases will only provide an "opportunity" to recover the revenues, because competition will prevent SLCs from being placed at the caps.[60] These claims are made in the face of the fact that the current supposedly competitive environment has not prevented the current SLCs from being priced at the maximum allowed for each carrier.
The Chairman's Draft Proposal claims that

> there is evidence that incumbent LECs charge rates below even the existing caps in a number of instances. For example, the primary residential and single-line business SLC cap is $6.50, but the national average SLC for those lines is $5.93 based on recent Commission data. Similarly, the non-primary residential line SLC cap is $7.00, but the national average SLC for those lines is $5.81. Further, the multi-line business and Centrex line SLC cap is $9.20, but the national average SLC for those lines is $6.30 -- nearly $3.00 below the cap.[61]

This "evidence" is completely misleading, ignoring the fact that, although there is a $6.50 SLC cap on primary residential lines, each carrier's actual SLC is based upon its revenue requirement[62]; if the revenue requirement of the carrier produces a rate below the cap, the lower amount is what must be charged. The Chairman's Draft Proposal contains no shred of evidence that shows that competition -- or any other force -- has required an ILEC to charge a SLC below its regulatorily-determined revenue requirement.
Further, the Chairman's Draft Proposal incorrectly states that "[t]he interstate SLC is a flat-rated charge that recovers the interstate portion of local loop costs from an end user."[63] That may have been the intention when the SLC was originally devised, but today the interstate SLC is greater than the interstate portion of the local loop costs because the Commission assigned non-loop marketing and transport cost to loop costs when it determined the allowed SLC revenues in the CALLS proceeding. Thus, even prior to the Commission cost review, the SLC rates were greater than the interstate loop costs. Yet as explained in the Free Press ex parte (Appendix D at 6, footnotes omitted),

> When the Commission adopted the current $6.50 SLC cap in the *CALLS Order*[6] it ruled that a further cost review proceeding would have to be undertaken in order to determine if SLCs should rise above $5.00. Specifically, the Commission stated that in this cost review proceeding it would "examine, forward-looking cost information associated with the provision of retail voice grade access to the public switched telephone network." When the review proceeding was concluded, it became apparent that very little verifiable actual forward-looking cost information had been submitted to the Commission. In the June 2002 *Order*, the Commission ruled that the $6.50 cap was reasonable, despite the conclusion that approximately 82 percent of residential and single-line business price-cap lines had forward-looking costs below $6.50.

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[60] AT&T 7/17/08 ICC filing at 7.
[61] Chairman's Draft Proposal, ¶ 298 (footnotes omitted).
[62] 47 C.F.R. § 69.104(n)(1)(ii) (rate-of return carriers); 47 C.F.R. § 152(d)(1)(i) (price cap carriers).
[63] Chairman's Draft Proposal, ¶ 297.

If the SLC were to be raised to $8.00, there would be an even greater proportion of lines allowing over-recovery, and an even smaller portion of lines where there might be an under-recovery of costs from the SLC standing on its own. Equally importantly, there is no showing in the Chairman's Draft Proposal, unlike in the *CALLS Order*, that any portion of current interstate (or intrastate) access charges represents loop costs. And although the previous SLC increases were ostensibly based on costs, the Chairman's Draft Proposal appears to deliberately ignore costs (at least as far as the SLC is concerned).[64]

The Chairman's Draft Proposal also ignores the many other sources of revenues that will offset the lost access charge revenues. The Proposal also ignores the cost savings the carriers will enjoy as a result of paying the reduced access charges on all traffic.[65]

As noted in a NASUCA ex parte,

> AT&T's and Verizon's plans are explicitly built around AT&T's notion – expressed in a filing made with the Petition addressed in 08-152 – that "comprehensive reform" can only be accomplished in the context of a zero-sum game of only three "interdependent 'dials'" – terminating intercarrier rates, federal SLCs, and universal service support. Under AT&T's proposal, if intercarrier rates are reduced ("dialed down"), then either SLCs or the universal service fund ("USF") – or both – must be increased ("dialed up") to make up the difference. This proposal self-centeredly and simplistically ignores the full array of services from which AT&T (and other carriers) receive revenues – traditional wireline service, broadband services, and, indeed video and other services. Intercarrier compensation, SLCs and the USF are but three of the numerous spigots from which dollars flow to fill up the telephone companies' revenue buckets. All of these "buckets" must be included when addressing lost revenues.[66]

The Chairman's Draft Proposal purports to recognize these multiple revenue sources,[67] but makes no showing of why the SLC should be the first source of revenue recovery for lost access charge revenues.

The reasoning in the Chairman's Draft Proposal as to why the federal SLC should be available for recovering lost intrastate access revenues is transparently weak. It appears that the only rationale is that the increases would be part of a transition, as allowed by 47 U.S.C. 251(g).[68] As explained by Broadview Networks, et al., however,

> [T]he Commission cannot justify otherwise unlawful action (i.e., the exercise of authority over intrastate access traffic) on the basis that the action may be "interim" or "transitional" in nature. The label placed on the action by the Commission is irrelevant; what is determinative is whether the action itself is within the Commission's lawful authority.[69]

And the increases in the SLC would themselves be permanent, not transitional.

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[64] See Chairman's Draft Proposal, ¶ 300.
[65] 01-92, 04-36, NTCA ex parte (September 12, 2008) at 5.
[66] NASUCA ex parte (September 30, 2008) at 5-6 (footnote omitted).
[67] Chairman's Draft Proposal, ¶ 313.
[68] Id., ¶ 300.
[69] 01-92, Broadview Networks, et al. ex parte (October 23, 2008) at 5.

Further, the reasoning supporting the proposal is self-contradictory: The Chairman's Draft Proposal says that the SLC increases "help[] mitigate any need incumbent LECs might have to seek increases in state rates due to decreases in intrastate intercarrier compensation revenues during the initial stages of the transition…."[70], but also requires "that the LEC's state retail rates and any intrastate SLC be set at the maximum level permitted under state regulations."[71] Logically, one cannot require end-user rates to increase as a means to mitigate end-user rate increases.

Indeed, the Chairman's Draft Proposal notes that "[t]o the extent that a carrier's state retail rates have been deregulated, that carrier may not increase its SLCs to recover any net loss in intrastate intercarrier compensation revenues."[72] What will be the impact of partial deregulation of state retail rates? Practically speaking, the Chairman's Draft Proposal also includes no provision for how these things will be certified to the Commission, either by the ILEC or by the appropriate state commission, before the SLCs are increased.

Even under the Chairman's Draft Proposal's expansive view of FCC jurisdiction, states retain authority over end-user rates.[73] If intrastate access charges are reduced by the FCC -- which they should not be -- it should still be left to the states to devise mechanisms (if any) for recovery of the lost intrastate revenues. Many states already have such mechanisms in place; others are perfectly capable of adapting to the changes imposed by the FCC.

Given the importance of this issue, there are also significant details missing from the Chairman's Draft Proposal. One example is timing and verification. Apparently, the cap on the SLC is to be raised immediately, but there is no indication of when the lost revenues will be used to allow SLCs to increase up to the cap. For instance, for the larger carriers, in many states intrastate access charges currently mirror the interstate rates. Thus during the first phase of the proposed transition -- where intrastate access charges are reduced to interstate levels -- there should be, for these carriers at least, no need for an increase in the SLCs at all.

It is also not clear that the increases to the SLC in a particular ILEC's service territory can only be allowed for the recovery of access revenue **in that territory**.[74] This must be made clear, so as to prevent customers in one state from replacing revenue losses from another state.

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[70] Chairman's Draft Proposal, ¶ 300.

[71] Id., ¶ 299. It is not clear what "the maximum level permitted under state regulations" means. Is this the maximum under any currently-effective price cap or other alternative regime (where the need for the increase need not be shown), or is it the maximum following a traditional rate case (where the need for the increase must be proved)?

[72] Id., n.784. The term "net loss" is not explained; it does not appear to include offsets from additional revenues or cost savings from paying reduced ICC rates.

[73] Although the Chairman's Draft Proposal does state that "[t]o the extent that interstate end-user charges are used to offset any lost intrastate intercarrier compensation revenues, we mandate that the states take account of those revenues in their state ratemaking by reducing the intrastate costs or revenue requirement to be recovered through intrastate rates." Id., n. 799. This ignores the wide variety of state ratemaking methods and capabilities. And there is no legal authority cited for this preemption, either.

[74] See 01-92, et al., Qwest ex parte (October 28, 2008) at 2 (recommending that the Commission "[p]ermit carriers to average SLC increases under the new plan across states").

Finally, the Chairman's Draft Proposal refers to the Federal-State Joint Board on Separations ("Separations Joint Board") issues regarding "the need for any additional increases in interstate end-user rates for carriers to recover any net loss in interstate and/or intrastate intercarrier compensation revenues as a result of the reform measures" proposed in the Chairman's Draft Proposal.[75] Without addressing the specifics of the referral, it seems the choice of the Separations Joint Board is curious, given that end-user rates fall more within the purview of the Universal Service Joint Board.

Overall, these aspects of the Chairman's Draft Proposal are not justified. They should not be adopted.

IV. THE COMMISSION SHOULD NOT USE THE USF AS A MEANS OF LOST ACCESS CHARGE REVENUE RECOVERY.

The Chairman's Draft Proposal posits the USF as a secondary means of recovering lost access charge revenues.[76] The Chairman's Draft Proposal seeks "to ensure that any new universal service subsidies are targeted carefully to situations where they are most crucially needed."[77] The Chairman's Draft Proposal states, "Therefore, for price cap carriers, we adopt the proposal of various commenters to consider all a company's costs and revenues -- both regulated and non-regulated -- before providing new universal service support."[78]

The provision of the "new universal service support" is to be done based on different standards for rate-of-return and for price-cap carriers:

> *Rate-of-Return Incumbent LECs*. For incumbent LECs subject to rate-of-return regulation, a carrier may qualify for universal service funding if it can demonstrate that, it will not have a reasonable opportunity to earn its authorized rate of return as a result of its net loss of revenues caused by the changes in intercarrier compensation rates resulting from this order, even after having increased its interstate SLC, state SLC (if any), and state retail local rates to the maximum permitted by applicable law.
>
> *Price Cap Incumbent LECs*. For incumbent LECs subject to price cap regulation, a carrier may qualify for universal service funding if it can demonstrate that, as a result of reduced and reformed intercarrier charges, and after accounting for increased end-user charges, it is still unable to earn a "normal profit." In the *Local Competition First Report and Order*, the Commission discussed the concept of normal profit and defined it as the "total revenue required to cover all the costs of a firm, including its opportunity costs."[79]

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[75] Chairman's Draft Proposal, ¶ 303. Here again, the reference is to "net loss," again undefined.

[76] Id., ¶ 311. Actually, given the requirement that intrastate end user rates be "at the maximum level" (id., ¶ 299), the USF would be a tertiary recourse, except under the Alternative Proposal, where it is the strongest guarantee of all.

[77] Id., ¶ 313. It is not explained why such targeting is not appropriate for the proposed SLC increases.

[78] Id., ¶ 314.

[79] Id., ¶¶ 322-323.

Clearly, this is superior to a carte blanche award of USF to carriers to replace lost revenues.[80] Unfortunately, just such an award is contemplated for rate-of-return carriers in the Alternative Proposal, where the only precondition for receiving USF is that they be rate-of-return carriers on the federal level.[81] These carriers are not even required to have raised their local rates to the maximum allowed under state regulation. The Alternative Proposal contains no support for this guarantee, other than the OPASTCO/WTA proposal, which merely sets forth the demands of these carriers.[82]

As noted earlier, "the devil is in the details," and the details in the Chairman's Draft Proposal are seriously undefined, raising questions such as:

- The reference to the authorized rate of return is presumably to the Commission's ancient 11.25% authorized return, which should have been updated long ago. It is not reasonable and the Commission should no longer condone the use of the 11.25 percent rate of return. This rate of return was established in 1990.[83] At the time the 11.25 return was authorized, the short-term interest rate was 8.0 percent and the long-term interest rate was 8.4 percent.[84] The current short term interest rate for the week ending November 14, 2008 is 0.21%, and the long term interest rate is 4.58 percent for the same week.[85] Moreover, this return was based on large carriers' capital structure. If a rate-of-return criterion for this USF should be adopted, it should be the individual carrier's capital structure, the individual carrier cost of debt and a cost of equity equal to the RUS loan plus a 2.5 percent risk premium. Failure to adopt such a standard allows carriers to earn equity profits based on financial leverage and debt heavy capital structures. For example, if a carrier has a 5 percent debt cost and debt percentage of 60 percent, its return on equity increases to 20.63 percent. This bloated return was not reasonable in 1990 when the 11.25 percent was first adopted and is clearly not reasonable today.

- Despite claims in the Chairman's Draft Proposal that this approach takes into account the '"new and growing source[s] of revenues [that] should mitigate the impact of intercarrier compensation reform for rural and other carriers,'"[86] those sources of revenues -- which are largely deregulated -- do not go into the calculation of an authorized return.

- In contrast to the authorized rate of return for rate-of-return carriers -- which is fixed but long-obsolete -- the standard of "normal profit" for price cap carriers is vague and will be the subject of substantial dispute.

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[80] As urged by some rural carriers. See, e.g., 01-92, 04-36, National Telecommunications Cooperative Association ex parte (November 18, 2008) at 3.

[81] Alternative Proposal, ¶ 320.

[82] Neither does the record contain support for the "second component" of the Alternative Proposal's proposal, providing support to make up for lost access minutes on a going-forward basis.

[83] *Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 89-624, Order, 5 FCC Rcd 7507 (1990).

[84] Id., ¶170.

[85] http://www.federalreserve.gov/releases/h15/Current/.

[86] Chairman's Draft Proposal, ¶ 313, quoting NASUCA July 7, 2008 Supp. Comments at 6.

Essentially, the Commission is adopting a new criterion for receipt of the USF, one that will apply only to the "additional" USF funding that is sought to replace lost ICC revenue.[87] What is missing here, of course, is any connection to the primary purpose of the high-cost USF under federal law: To ensure that rates and services in rural areas -- not returns -- are reasonably comparable to those in urban areas.[88] The Commission should not adopt these aspects of the Chairman's Draft Proposal.

V. THE CHAIRMAN'S DRAFT PROPOSAL ON PHANTOM TRAFFIC COULD BE ADOPTED.

The Chairman's Draft Proposal describes the problem of so-called "phantom traffic," which is "traffic arriving for termination with insufficient identification information" to allow operation of "the technical systems and processes used to create, transfer, and gather intercarrier compensation billing information."[89] The Chairman's Draft Proposal would amend the Commission's rules "to facilitate the transfer of necessary information to terminating service providers, particularly in cases where traffic is delivered through indirect interconnection arrangements."[90] NASUCA has long agreed that there is a need for rules to address the issue of phantom traffic.[91] Therefore, NASUCA supports the adoption of both rules requiring identification of traffic[92] and rules that establish financial responsibility for traffic.[93]

VI. THE CHAIRMAN'S DRAFT PROPOSALS ON BROADBAND DEPLOYMENT SHOULD NOT BE ADOPTED.

The issue of the deployment of broadband service is a hot one, with virtually all parties supporting moves to increase the availability of broadband throughout the United States. NASUCA largely supported the Joint Board's Recommended Decision on this subject, which would have 1) defined broadband as a supported service under 47 U.S.C. § 254(b), (c) and (e); and 2) established a separate fund to support deployment of broadband, focusing on unserved areas. NASUCA proposed two significant changes: The fund should not cover wireless broadband, given the limitations of the service and the current level of customer subscription, and funding for broadband deployment should also come from assessments on broadband services themselves.[94] NASUCA continues to support those positions.
The Chairman's Draft Proposal takes a substantially different tack, by conditioning receipt of high-cost universal service support by incumbent LECs on whether they "certify whether or not

[87] A criterion to prevent or limit high-cost funding for carriers earning high returns might be appropriate for all high-cost USF funding.
[88] 47 U.S.C. § 254(b)(3).
[89] Chairman's Draft Proposal, ¶ 327; see also id., ¶ 328.
[90] Id., ¶ 329.
[91] See, 01-92, NASUCA Reply Comments (July 20, 2005) at 47-48.
[92] See 01-92, et al., CenturyTel ex parte (September 19, 2008) at 3 (describing a study area where "approximately 50% of a major carrier's traffic is unidentifiable and they claim it is interstate").
[93] Chairman's Draft Proposal, ¶¶ 337-338.
[94] 05-337, 96-45, NASUCA Comments on Joint Board Recommended Decision (April 17, 2008) at 16-20.

they will commit to offering broadband Internet access throughout their supported study areas in five years. Those who make that commitment will continue to receive their current levels of support."[95] Those who do not make this commitment will have their study areas declared to be "Unserved Study Areas," that will be subject to reverse auctions, "awarding high-cost support to a bidder that will commit to take on carrier of last resort obligations and to offer broadband Internet access service throughout the study area."[96] Likewise, CETCs will be required to offer broadband service throughout their service areas.[97]

Subsequent to the initial certification, the Chairman's Draft Proposal would require "each provider receiving high-cost support to meet specific milestones with regard to broadband deployment in the years preceding completion."[98] Specifically, the Chairman's Draft Proposal

> adopt[s] milestones based on customer locations where the incumbent LEC or competitive ETC is not yet offering broadband Internet access service (Unserved Customers). Specifically, we require incumbent LECs and competitive ETCs to be capable of providing broadband Internet access service to an additional 20 percent of their Unserved Customers by the end of each year of the five-year build-out period. This requirement means that, of the total number of Unserved Customers in the service area, these carriers must offer broadband to 20 percent by the end of year one, 40 percent by the end of year two, 60 percent by the end of year three, 80 percent by the end of year four, and 100 percent by the end of year five.[99]

Failure to meet any milestone will result in loss of eligibility for support for that service area. If the ETC that loses its eligibility for support is an incumbent LEC, the study area will be subject to auction.[100] Unfortunately, the Chairman's Draft Proposal on broadband deployment will not serve the purpose of effectively expanding broadband availability, and should not be adopted.

There are numerous practical problems with this approach, including:

- How the ILEC will determine the customer locations in its Unserved Areas, and how this will be monitored.[101]

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[95] Chairman's Draft Proposal, ¶ 20. The commitment is for service with download speeds equal to or greater than 768 kbps and upload speeds greater than 200 kbps. Id., ¶ 28.
[96] Id., ¶ 31.
[97] Id., ¶ 20.
[98] Id., ¶ 57.
[99] Id., ¶ 59 (footnote omitted).
[100] Id., ¶ 61. The Chairman's Draft Proposal also notes that failure to be fully compliant by the end of the build-out period will result in the loss of support. Id. It appears that this should be subsumed into failure to meet a milestone.
[101] Will a customer who has "cut the cord" and gone to wireless as an inferior substitute for basic service be excluded from this list of locations?

- The failure to meet a milestone is apparently the "death penalty" for support, with no provision for the ETC to cure the failure before loss of support.

- As discussed in Section VI.C. below, the fact that the milestones are "even," requiring a 20% additional accomplishment in each year, ignores that it is likely to be far more expensive to reach the last 20% of an unserved area than the first 20%, unless there is an additional requirement that bars such prioritization based on cost.

The fundamental problem is the question of how the Commission can, under § 254, condition receipt of high-cost support -- which is supposed to be limited to "the provision, maintenance and upgrading of facilities and services for which the support is intended"[102] -- on the provision of facilities and service that have **not** themselves been defined as supported facilities and services. The Chairman's Draft Proposal does not define broadband as a supported service, and makes no provision that would make spending high-cost funds on broadband proper under the Act.[103]

As a general proposition, all of the proposals discussed in the FNPRM fail to adequately address the question of how broadband will be funded. As it stands, voice services will be picking up the tab for broadband services addressed in the order, both the deployment supported with high cost funds and the broadband lifeline pilot. It is unreasonable and untenable for surcharges on voice services to be the exclusive source of support for broadband. Both the Chairman's Draft Proposal and the Alternative Proposal sidestep this issue.

A. REQUIRING BROADBAND DEPLOYMENT ONLY FOR CARRIERS RECEIVING HIGH-COST FUNDS MISSES THE REAL PROBLEM.

Quite apart from the question of where the ETCs are supposed to get the funds to pay for the broadband investment -- since high-cost USF payments are not supposed to be used for that purpose -- there is a substantial question of whether the threat of eliminating those payments addresses the real problem. In the first media reports about the Chairman's Draft Proposal, it was indicated that the proposal would apply only to rural carriers; but it now appears that it would apply to all carriers that receive high-cost support.

As the Commission well knows, federal "high-cost support" comes from five separate programs, for which various companies qualify. Support for non-rural carriers comes principally from two

[102] 47 U.S.C. § 254(e).

[103] It is widely known (and widely asserted) that many rural carriers have used their high-cost fund receipts to provide broadband. See, e.g., 01-92, et al. Fred Williamson & Associates, Inc. ex parte (October 23, 2008) at 1.

sources: (1) the high-cost model support mechanism ("HCM"), and (2) IAS.[104] These mechanisms amounted to $1.3 billion in 2007, including CETC support.[105] Support for rural carriers comes principally from three sources: (1) the high-cost loop support mechanism ("HCLS"); (2) local switching support ("LSS"); and (3) the interstate common line support mechanism ("ICLS").[106] In 2007, these mechanisms provided $2.986 billion in support, including to CETCs.[107]

Almost all, if not all, rural carriers receive high-cost support from one or more of these programs. On the other hand, most non-rural carriers also receive high-cost support, principally through IAS: As shown in the Appendix, in 2007 only fourteen non-rural ILECs in ten states did not receive **any** "high-cost" support. In 2007, fifteen non-rural companies in ten states received high-cost model funding. On the other hand, non-rural carriers in **forty-seven** jurisdictions received either interstate access or interstate common line support in 2007, but no HCM support. Thus the vast majority of carriers -- both rural and non-rural -- have funding that is at risk under the Chairman's Draft Proposal. The key question is, however, whether that risk is sufficient to produce certification and compliance with the build-out requirements.

The answer is, "Probably not," at least for the non-rural carriers.[108] As shown in the Appendix, the support many of these carriers receive on a per-line basis is low enough that they would likely make the economically rational choice to forgo high-cost support in order to avoid having to comply with the buildout requirements. Carriers that receive monthly support of 4¢ per access line (California, Iowa, Kansas) or 6¢ per line (Arkansas) or 7¢ (Oklahoma) will not likely certify that they will bring broadband to 100% of their territories within five years.

And the non-rural carriers that receive no support will not be covered at all. This includes carriers in Idaho, Illinois, Michigan, Missouri, Ohio, Texas and Wisconsin, where one doubts that 100% coverage has been achieved.[109]

Thus the gaps in the Chairman's Draft Proposal virtually guarantee that the broadband needs of many rural customers, especially the rural customers served by AT&T, Verizon and Qwest, will not be met. The proposal embodies the wrong approach (removing support if coverage is not achieved) and covers too few problem areas (only hitting carriers whose high-cost receipts are

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[104] There are a small number of rate-of-return non-rural carriers that receive Interstate Common Line Support, as described below, rather than IAS.

[105] USAC 2007 Annual Report at 44.

[106] There are a number of larger rural carriers who are price-cap carriers and receive support under IAS.

[107] USAC 2007 Annual Report at 43.

[108] It is widely known that rural carriers have done a better job of bringing broadband to their customers than have the non-rural carriers (at least in the rural portions of the non-rural carriers' territories). See http://www.insight-corp.com/reports/rural.asp. This calls into question the claims that high call termination rates (alleged to be rampant among rural carriers) deter broadband deployment. See Beard and Ford, "Do High Call Termination Rates Deter Broadband Deployment?" Phoenix Center Policy Bulletin No. 22 (October 2008).

[109] In Ohio, there are customers in an AT&T exchange approximately 25 miles from the center of Columbus (the state capitol and largest city) where no broadband service is available, either from AT&T or from the cable provider.

themselves high) to achieve the goals "to spur deployment and ensure that all Americans have access to broadband."[110]

B. THE COMMISSION SHOULD ESTABLISH INCENTIVES THAT WOULD MOTIVATE NON-RURAL CARRIERS TO MEET THE BROADBAND COMMITMENTS.

As noted above, the Chairman's Draft Proposal does not contain an incentive that would motivate non-rural carriers to meet the proposed commitment levels because the non-rural carriers, for the most part,[111] receive either minimal or no high cost support. As an alternative, the Commission could require non-rural carriers to reduce their SLCs and special access rates annually by ten percent if the carriers do not meet their commitments.

C. REQUIRING BROADBAND INTERNET ACCESS TO ALL CUSTOMERS IS EXCESSIVE AND UNREASONABLE

The Chairman's Draft Proposal requires carriers to commit to serve all customers in their territories in order to retain their current high-cost support. This requirement ignores the cost realities associated with broadband deployment. It is generally understood that deployment costs increase dramatically as carriers attempt to serve additional customers. That is, the cost of providing Internet access service increases substantially as carriers increase the service availability from 85 to 90 and then to 95 or 100 percent. This increase is due to the fact that carriers will generally attempt to serve the lowest cost customers first and then gradually increase service availability to higher cost customers. Therefore we propose that the Commission work with the states to develop realistic and cost-effective commitment levels. To this end, we recommend that the Commission should allow the commitment level to be reduced to no lower than 90 percent if a state commission investigates the cost of broadband deployment and determines that it is not cost-effective to require higher commitments. That is, if a state commission recommends a commitment level that is between 90 and 100 percent for a particular service territory, the Commission should accept that commitment level as reasonable and not require broadband Internet access to be provided to all customers as a condition of receiving high-cost support.

The inability to provide Internet access service is caused by the lack of digital subscriber line access multiplexers ("DSLAMs")[112] in central offices, the lack of fiber interoffice facilities, the lack of fiber in feeder facilities, the existence of the previous vintages of remote terminals, and/or the existence of load coils and excessive bridge taps. Adding DSLAM functionality in central offices is relatively cheap and usually the first step carriers take in the provision of Internet access service. But central office DSLAMs will only provide Internet service to customers who are served on short copper loops. All of the other activities required to provide Internet access service are progressively more expensive. The need for fiber in the feeder results

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[110] Chairman's Draft Proposal, ¶ 20.

[111] AT&T in Mississippi and Alabama and Verizon in West Virginia receive substantial high cost support.

[112] The functionality of DSLAMs includes the ability to split the electronic messages between the high frequency data message and the low frequency voice message. The high frequency data messages are delivered to a path that terminates at a packet switch, while the voice messages are delivered to a path that terminates at a circuit switch.

from the fact that data messages can overload the carrying capacity of copper feeder. Previous vintages of remotes block the passage of the high frequency messages and must be replaced or augmented. Load coils degrade the high frequency data messages while simultaneously enhancing the low-frequency voice messages. These cost factors make the approach in the Chairman's Draft Proposal impracticable -- if not impossible -- to achieve.

D. STATE COMMISSION REVIEW OF THE BROADBAND COMMITMENT IS ESSENTIAL.

State commissions are familiar with the individual service territories, the needs of the service territories and the cost of meeting those needs. State commission review of deployment plans will augment the Commission's goal of increasing broadband deployment, yet at the same time will make it more likely that the investments are reasonable and that the carriers have a reasonable opportunity to achieve the required commitment levels.

For example, during its recent review and approval of the Verizon New England sale of its Maine service territory to FairPoint, the Maine Public Utilities Commission investigated FairPoint's broadband deployment plan. Testimony regarding the plan was submitted by FairPoint and the Maine Office of the Public Advocate. The FairPoint testimony contained detailed information regarding the cost of FairPoint's initial deployment plan and what it would cost to provide Internet access service to customers that were not in the initial plan.[113] Even though the initial FairPoint plan increased the number of customers to be offered broadband Internet Access service, the Public Advocate recommended that Internet access service (through DSL) should be available to 90 percent of FairPoint's customers at the end of a five-year deployment schedule.[114] This increase was substantially greater than the FairPoint proposal, but still well below the proposed requirement in the Chairman's Draft Proposal here.

In terms of investment dollars, FairPoint initially proposed to spend $17 million in Maine. To meet the Public Advocate's proposal, Verizon agreed to finance an additional $12 million in DSL deployment investments, while Fairpoint increased its investment commitment by an additional $40 million. The Maine Commission found that the Public Advocate's proposal was reasonable and has directed FairPoint to invest the additional dollars required to meet that goal.[115]

The Maine Commission decision and the FairPoint deployment are dependent on the continued receipt of high cost funds by FairPoint. However, if adopted the Chairman's Draft Proposal would withdraw those funds and undermine the FairPoint Maine deployment plan. Thus, in the Maine case in particular and likely in many other states, the Chairman's Draft Proposal, rather than promoting increases in Internet access service, would retard the provision of that service. On the other hand, this Commission working with the state commissions would be able to forge a joint process that would support the Chairman's goals.

[113] Prefiled Joint Rebuttal Testimony of Michael L. Harrington, Michael S. Brown and John Smee on behalf of FairPoint Communications Regarding Topic Groups II and III, August 22, 2007, Maine Public Utilities Commission, Docket No. 2007-67

[114] Surrebuttal testimony of Robert Loube, Ph.D. on behalf of the Office Public Advocate, Maine Public Utilities Commission, Docket No. 2007-67 (October 1, 2007).

[115] Maine Public Utilities Commission, Order, Docket Nos. 2007-67 and Docket No. 2005-155 (February 1, 2008).

E. LIMITING THE SUPPORT PROVIDED TO RURAL ILECS TO 2008 OR 2010 AMOUNTS IS COUNTER PRODUCTIVE AND WILL NOT ENHANCE THE BROADBAND NETWORKS OF RURAL CARRIERS.

The Chairman's Draft Proposal limits the high-cost support received by rural ILECs to their 2008 funding by carrier if the rural ILEC carrier meets the proposed commitment levels.[116] It is our understanding that the overwhelming majority of rural rate-of-return carriers either already conform to the commitment levels or are very close to conforming to the commitment levels. Therefore, the Chairman's broadband proposals do not provide a significant incentive to enhance rural ILEC networks. On the other hand, many rural ILECs are planning to make substantial additional improvements to their current networks. These improvements include building fiber-to-the-home networks.[117] Without additional universal service funding, the rural ILECs will not be able to finance such projects. Therefore, instead of enhancing the broadband capability of telephone networks, the Chairman's proposals will freeze in place the current broadband services. The rural carriers will not be able to participate in the new broadband environment and will be condemned to be relics of a by-gone era.

F. THE COMMISSION SHOULD ESTABLISH A BROADBAND DEPLOYMENT FUND.

The Commission should establish a broadband deployment fund as proposed by the Universal Service Joint Board. This fund should be used to help carriers meet the financial obligations associated with the deployment of advanced broadband facilities. The broadband deployment fund should itself be funded in substantial part by assessments on broadband services -- DSL, cable modem and wireless.

As an additional incentive, the broadband deployment fund could be made available to any rural carrier that purchases exchanges from a non-rural carrier, or to rural carriers that substantially increase their investments in order to deploy advance broadband facilities. With regard to rural carriers that purchase exchanges from non-rural carriers, in order to participate in the broadband deployment, each carrier would have to commit to a five-year deployment plan. The plan would require deployment of advanced broadband facilities to at least 90 percent of the customers in the purchased exchange.[118]

With regard to rural carrier investment in advanced broadband facilities in their existing territories, if those carriers commit to increase their gross investment by 20 percent, the carriers would be allowed to obtain support associated with that investment from the broadband

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[116] Chairman's Draft Proposal, ¶ 29.

[117] See for example, Union River Telephone Co., Maine Public Utilities Commission, Docket No. 2008-009.

[118] The support would equal the difference between the revenue and the revenue requirement in the acquired exchanges. However, the revenue requirement would be based on each carrier's cost of debt, capital structure and a revised cost of equity. The revised cost of equity would be the Rural Utility Service (RUS) loan rate plus a 2.5 percent risk premium (or approximately 7.5 percent). In addition, if the carrier provides data or video services through an affiliate a portion of the loop cost must be assigned to the affiliate. As a safe harbor assignment, we proposed that if the carrier provides data service, then the affiliate is responsible for 20 percent of the loop costs per customer, if the carrier provides video service then the affiliate is responsible for 40 percent of the loop costs per customer, and if the carrier's customer purchases a triple play service then the combined affiliates are responsible for 60 percent of the loop costs.

deployment fund. The amount of support would be the difference between the carrier's total revenue and the revenue requirement associated with the change in the carrier's investment. Each carrier would have to commit to a five-year deployment plan. The plan would require deployment of advanced broadband facilities to at least 90 percent of the customers in the purchased exchange. For the purposes of this commitment, advanced broadband facilities are facilities that allow the customer to obtain download speeds of at least 3 mbps. The revenue requirement would be calculated using the revised cost of capital and cost assignments to affiliates would also be required.

G. THE COMMISSION SHOULD NOT USE REVERSE AUCTIONS AS A PENALTY FOR FAILING TO HAVE 100% BROADBAND DEPLOYMENT.

The notion of reverse auctions as a means of addressing universal service needs is an idea that apparently will not die. NASUCA has long opposed the general use of reverse auctions.[119] The Narrow Proposal would change all high-cost support to a reverse-auction system.[120] It should be rejected out of hand, consistent with the continual valid objections to such a process.

Yet as NASUCA has stated, "[T]he record supports the possible use of auctions for high-cost funding only in currently unserved territories. Auctions would be particularly appropriate as pilot programs for broadband or mobility service in such areas."[121] The Chairman's Draft Proposal is not a pilot program, where the concept can be tried out in action. Rather, reverse auctions are proposed as an across-the-board policy.

More importantly, the reverse auction process in the Chairman's Draft Proposal does not apply only in currently unserved territories. Rather, it would apply to the entire service area of a carrier if the carrier falls short of the buildout milestones in any part of its territory. (In this instance, the punishment clearly does not fit the crime.)

This is particularly problematic because the Chairman's Draft Proposal would strip the incumbent of its ETC designation, and apparently of its carrier of last resort obligations.[122] As NASUCA stated in reply comments on this subject:

> AT&T's comments point out, however, that the reverse auction raises the extremely significant issue of what happens to the obligations to serve of an ILEC that is not selected as the winning bidder in an auction. AT&T is concerned that it is unclear whether the FCC has the authority to relieve a losing ILEC bidder of its COLR obligations, correctly pointing out that states impose COLR obligations on ILECs. Embarq argues that if the FCC is to implement reverse auctions, it would have to preempt both COLR obligations and rate-of-return regulations for ILECs who lost auctions.
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> This is an extremely important issue that cannot be brushed aside as cavalierly as auction proponents might wish. The FCC lacks the authority to preempt states in these intrastate ratemaking matters, nor should it attempt to do so.[123]

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[119] See generally, 05-337, 96-45, NASUCA Comments on Using Reverse Auctions to Determine High-Cost Universal Service Support (April 17, 2008) ("NASUCA 4/08 Auctions Comments").
[120] Appendix B, ¶¶ 18-38.
[121] NASUCA 4/08 Auctions Comments at 2.
[122] Chairman's Draft Proposal, ¶ 39.

Indeed, stripping the incumbent of its ETC status would have additional (presumably unintended consequences), including that the incumbent would no longer have an obligation to provide Lifeline service. This will be extremely disruptive for consumers, and not likely to be acceptable to any state regulatory commission.[124] For non-rural carriers, low-income support may be substantially greater than high-cost support. Two extreme examples are AT&T-California and AT&T-Texas. AT&T-California receives $48 million in low-income support and only $8.6 million in high cost support, while AT&T-Texas receives $18.2 million in low-income support and no high cost support.[125]

Further, the Chairman's Draft Proposal sets the reserve price for an auction "at the incumbent LEC's current level of high-cost support...."[126] This would be the "maximum level of high-cost support that participants in the auction would be allowed to place as a bid."[127] Yet if the incumbent could not accomplish ubiquitous broadband coverage with that amount of support, why should it be expected that another carrier would? It seems highly likely that such auctions would produce no bidders, because "the winning bidder will be the one who commits to offer the highest speed of broadband service -- throughout the entire Unserved Study Area -- at a bid amount that is equal to or less than the reserve price (the incumbent LEC's current high-cost support amount)."[128] Thus much of the detail of the process contained in the Chairman's Draft Proposal[129] would prove to be unnecessary. This part of the Chairman's Draft Proposal should not be adopted.

As an alternative to reverse auctions, non-rural carriers could be encouraged to sell their rural exchanges to rural carriers. The sale of the exchanges to rural carriers is preferable to a reverse auction because the purchasing carriers are in position to provide service to customers immediately. The purchasing carriers would not have to purchase the entire service territory. The non-rural carriers could retain the exchanges where they can meet the proposed commitment levels. These exchanges are probably the exchanges where the non-rural carrier is currently investing in broadband facilities.

The exchanges that would probably be sold are exchanges in the non-rural carriers' UNE zones 3 and 4. Broadband Internet access service coverage is probably significantly lower in UNE zone 3 and 4 exchanges. As a working hypothesis, the Commission could assume that broadband Internet access service is probably available to only 60 percent of UNE zone 3 and 4 customers while in UNE zones 1 and 2, the availability would be closer to 85 or 90 percent. The Commission could verify this working assumption by requiring AT&T, Verizon, and Qwest to provide information on Internet access service availability by wire center which the Commission's staff could then roll up into availability by UNE zone.

Simultaneously the Commission should provide the rural carriers with an incentive to purchase the rural exchanges. These incentives would include the ability to purchase a limited number of the offered exchanges and the ability to obtain additional universal service support. The ability to

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123 05-337, 96-45, NASUCA Combined Reply Comments (June 2, 2008) at 38-39.

124 Chairman's Draft Proposal, ¶ 39.

125 As discussed above, it seems unlikely that the threat of losing $8.6 million in high-cost support will incent AT&T-California to commit to ubiquitous broadband service.

126 Id., ¶ 37.

127 Id., ¶ 36.

128 Id., ¶ 44.

129 Id., ¶¶ 45-50.

obtain additional support would be predicated on the Commission waiving its 47 C.F.R. § 54.305 "parent-trap" rule and establishing a broadband deployment fund as recommended by the Joint Board.

VII. THE CHAIRMAN'S DRAFT PROPOSAL ON BROADBAND FOR LIFELINE CUSTOMERS NEEDS REFINEMENT.

A. INTRODUCTION

NASUCA supports the concept of federal USF support for Lifeline Broadband but cautions that important consumer protections must be adopted before implementation of even a pilot program. At the outset, the authority of the FCC and state commissions to establish standards for ETC designation and performance as part of the Lifeline Broadband pilot ("the Pilot") must be acknowledged. Clear consumer protection standards related to installation, quality of broadband Internet access service provisioned, disconnection, and privacy must be established. Current and newly-designated ETCs must commit to meet these consumer protection standards as a condition of being eligible to participate in the Lifeline Broadband Pilot. Even if the ETC sells or provisions the broadband Internet access service of an affiliate or other provider, the ETC is subject to the jurisdiction of the FCC or state commission and must be prepared to meet the consumer protection standards. Most importantly, NASUCA emphasizes that the core universal service goal of affordable telecommunications service for low-income households should not be jeopardized by pursuit of the Pilot's goal of increasing broadband subscription rates among those households.

B. SCOPE OF THE PILOT

As proposed, the Lifeline Broadband Pilot would be open to low income households across the country, so long as an ETC a) has notified the FCC of its intent to participate and b) is prepared to offer Lifeline Broadband Internet access service and an access device "to all qualifying consumers throughout its service areas."[130] NASUCA agrees that a pilot limited to just a few states, as proposed by TracFone, would not be appropriate.[131] The number and variety of ETCs and service platforms used to offer Lifeline voice service varies between states and between rural and urban areas. The proposed Pilot would allow incumbent and competitive ETCs to offer Lifeline Broadband and would allow more Tribal areas to also benefit.

Even if the Pilot were to be open to ETCs in all states, NASUCA questions whether all areas would actually be served by an ETC willing and able to participate in the Pilot. First, the proposed Pilot would allow participation by ETCs to be voluntary. So whether an area is served by one ETC or several, it is possible that low-income households in some service areas may have no opportunity to benefit from the Pilot, if no ETC opts in to offer Lifeline and Link-Up broadband Internet support. This may be a necessary part of a Pilot, but, as previously noted, NASUCA supports adding wireline broadband Internet access to the 47 U.S.C. 254 definition of supported universal services. This would ensure that every service area has at least one ETC

[130] Chairman's Draft Proposal, ¶ 87.
[131] Id., ¶ 85.

obligated to offer low-income customers not only Lifeline and Link-Up voice support but also broadband Internet access.[132]

Second, NASUCA is concerned that the obligation to offer broadband Internet access throughout the ETC's entire service area in order to qualify will also impair the reach of the Pilot. Low-income consumers served by small rural local exchange carriers ("RLECs") may be eligible, to the extent the RLEC ETC has already modernized its telecommunications network to support broadband Internet access. However, the requirement that an ETC offering Lifeline Broadband must make broadband Internet access available throughout its service or study area may result in low-income consumers in some areas having no ETC participating in the Pilot, and thus no opportunity to benefit from the Pilot.

The requirement that an ETC be able to "offer the [Lifeline Broadband Internet access] services and supported devices to all qualifying low-income consumers throughout its service areas" must be more specifically defined. Would an incumbent wireline ETC be eligible to participate in the Pilot if the ETC is pursuing a plan to deploy broadband Internet access throughout its service area within a fixed period of years?[133] Would a wireless ETC be eligible to participate in the Pilot if the ETC supports wireless broadband Internet access only in portions of its designated service area? Does the requirement of broadband Internet access mean that it must be immediately available or can be available within a fixed period of days after the ETC receives a request for connection to the broadband network?

When an applicant requests FCC designation as an ETC, 47 C.F.R. 54.202 requires the applicant to certify that it will "(A) provide service on a timely basis to requesting customers where the applicant's network already passes the potential customer's premises; and (B) provide service within a reasonable period of time, if the potential customer is within the applicant's licensed service area but outside its existing network coverage, if service can be provided at reasonable cost, by" making some adjustments or investment in facilities. NASUCA has two concerns. First, this certification standard only applies to those ETCs designated by the FCC or by states that have adopted the FCC's standards, and applies only to supported services. So for ETCs in other states, there would be no comparable guideline regarding an ETC's obligation to make supported services available, much less the broadband Internet access service covered by the Pilot. Second, the caveat "at reasonable" cost might result in low-income households being excluded from the Pilot, even if the low-income household is in a participating ETC's service territory.

Thus, a more specific and clear description of the benchmark to determine whether an ETC, in any state or the District of Columbia, is able to provide broadband Internet access service throughout its service area, and so is eligible to participate in the Pilot, is a necessity. Making Lifeline and Link-Up support available to help low-income households to subscribe to broadband

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[132] NASUCA supported including broadband as a supported service in the context of the Joint Board's proposal for a separate Broadband Fund. 05-337, et al, NASUCA Comments on Joint Board Recommended Decision (April 17, 2008) at 16.

[133] NASUCA understands that under the Chairman's Draft Proposal, which would condition high-cost support on broadband deployment obligations, the answer appears to be that some Lifeline voice consumers might not be able to benefit from the Pilot if the ETC plans to take a number of years to make broadband access service available throughout the service area. See Chairman's Draft Proposal, ¶ 28.

Internet access service is of no value if the request for service can be turned down as too expensive to connect. Similarly, if wireless or other technology supports broadband service, but is subject to degraded connections or dead zones, then the value of Lifeline and Link-Up support for low-income households is likewise diminished. NASUCA's members represent the interests of both consumers who would be required to support the possible $300 million annual increase in the Federal USF and the low-income households that may benefit from the Pilot. NASUCA urges the Commission to take steps to clarify and strengthen the obligations of ETCs to make broadband Internet access service uniformly available and of a consistent quality to ensure that both the public that supports the federal USF and the eligible low-income households benefit from the Pilot.

Further, participating ETCs should be required to track and report data that will help the FCC, NASUCA and other interested parties assess the role which deployment, mapping, and technology issues play in the level of Lifeline Broadband participation rates. Despite the best efforts in designing a Pilot such as this, errors and failures to connect eligible low-income households might occur. Collection of data to identify problems which occur on the ETC's side should be part of the Pilot.

C. ADDITIONAL ETC OBLIGATIONS AND CONSUMER PROTECTIONS MUST BE ADOPTED AS PART OF THE LIFELINE AND LINK-UP BROADBAND PILOT

As proposed, eligible low-income households would be able to purchase voice service and broadband Internet access from the same ETC and receive federal Lifeline and Link-Up support for each.[134] The existing Lifeline and Link-Up regulatory framework for telecommunications support would apply to ETCs and to consumers participating in the Lifeline Broadband Pilot.[135] NASUCA supports this approach as a good starting point. However, for the protection of low-income consumers who would receive Lifeline and Link-Up broadband support, specific ETC obligations must be spelled out in advance. Additionally, the Section 54.410 certification and verification process must be modified to assure that Lifeline consumers do not lose Lifeline voice support due to questions over eligibility for Lifeline and Link-Up broadband.[136]

As proposed, ETCs participating in the Pilot must follow the requirements of Section 54.405 "Carrier Obligation to Offer Lifeline Service" "as applicable."[137] NASUCA supports this obligation. Section 54.405 requires ETCs to publicize the availability of Lifeline service and to provide notice and an opportunity for a Lifeline consumer to prove continued eligibility to prevent termination from Lifeline, consistent with the annual verification provisions of Section 54.410. Section 214(e) of the Communications Act of 1934 requires ETCs to "advertise the availability of such services and the charges therefore using media of general distribution," where "such services" refers to those universal services supported by the Federal USF.[138] Clearly, ETCs that participate in the Pilot must advertise the availability of Lifeline and Link-Up

[134] Chairman's Draft Proposal, ¶ 81.
[135] Id., ¶ 83.
[136] 47 C.F.R. § 54.410.
[137] Chairman's Draft Proposal, ¶ 87.
[138] 47 U.S.C. § 214(e).

support for both voice and broadband, including information about the charges for such universal services.[139]

The Section 54.405 framework assures Lifeline voice consumers of written notice and an opportunity to verify their continued eligibility for Lifeline support for voice services; this requirement must also apply to ETCs that participate in the Pilot. Low-income consumers who qualify for Lifeline Broadband support should have the same process and protections, even if a state's existing dispute resolution processes for telecommunications service providers and Lifeline voice consumers would not otherwise apply to broadband Internet access services.

Even if the ETC sells or provisions the broadband Internet access service of an affiliate or a third party, the ETC is subject to the jurisdiction of the FCC or state commission and must be prepared to meet these consumer protection standards.

NASUCA is concerned that the existing Lifeline and Link-Up framework does not extend other necessary consumer protections to low-income households that might obtain Lifeline and Link-Up broadband support. The Commission's Section 54.202 ETC designation standards do require ETC applicants to commit to "satisfy applicable consumer protection and quality of service standards" such as wireless industry guidelines. However, there is no ready parallel set of such minimum and uniform guidelines for providers of broadband Internet access and broadband access devices, much less guidelines that would apply to all ETCs participating in the Pilot, without regard to whether the ETC was designated by a state or by the FCC. NASUCA submits that this lack of uniformity must be remedied before the Pilot can proceed.

Consumer protection standards must recognize that the low-income household may be dependent on the ETC for both Lifeline and Link-Up for voice service and for broadband Internet access service. Basic standards governing the sale and installation of voice and broadband service must provide the consumer with sufficient information to decide whether to purchase voice alone or voice and broadband, as well as give a choice of pricing options including bundles of services -- with Lifeline and Link-Up support -- comparable to those offered by the ETC to other consumers. Providing low-income consumers with a choice of services with Lifeline voice and Lifeline broadband support benefits consumers with different needs and provides a way to ensure that the ETC is indeed passing through the federal Lifeline Broadband support amount.

The bill from the ETC for combined voice and broadband Internet access service must conform with Truth-In-Billing standards.[140] And regardless of how the Lifeline household purchases voice and broadband Internet access from the ETC, whether as individual services or as part of a bundle of services, the Lifeline consumer's voice service should not be subject to disconnection due to a later inability to pay for broadband Internet access. Consistent with the Pilot proposal, the ETC must recognize that the monthly Lifeline Broadband support "is separate from and in addition to their monthly Lifeline support for telephone service."[141] NASUCA supports the goal of the Pilot to increase broadband subscription among low-income households[142] but cautions

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[139] NASUCA supports adoption of more particular advertising guidelines, as set forth in comments and ex partes presented in the FCC's open *In re: Lifeline and Link-Up* rulemaking. See, *In re: Lifeline and Link-Up*, WC Docket No. 03-109, Report and Order and Further Notice of Proposed Rulemaking 19 FCC Rcd 8302, ¶¶ 23-40 (Apr. 29, 2004).

[140] Chairman's Draft Proposal, ¶ 81.

[141] Id., ¶ 82.

[142] Id., ¶ 72.

that the core goal of universal telecommunications service should not be compromised. ETCs should not be allowed to use the threat of the loss of either voice service or Lifeline voice support as leverage to collect payment for broadband Internet access service or other services. Strong consumer protection standards also need to be developed and applied to the proposed Link-Up support for a broadband Internet access device. As proposed, the Pilot would support

> 50 percent of the cost of broadband Internet access service installation, including a broadband Internet access device, up to a total amount of $100. The device can be a laptop computer, a desktop computer, or a handheld device, so long as the device has the capability to access the Internet at the speeds established per this order, and the equipment carries at least a warranty.[143]

If the device costs less than $100, the Pilot would support 90% of the cost of the device.[144] The Pilot would require ETCs to "make available a wide array of cost efficient broadband Internet access devices… to qualified consumers under this program."[145] The devices would be "non-transferable and the devices must be returned to an ETC if they are not used in compliance with the terms of this order or other applicable laws or regulations."[146] NASUCA agrees that low income consumers should have a choice of devices and should not be locked into use of just one type of device as a condition of receipt of Lifeline and Link-Up Broadband support. For example, laptop computers and handheld devices offer different mixes of utility, mobility and convenience -- the value of which might vary with the size and composition of the household.[147] Further, if low-income households must pay part of the cost of the broadband Internet access device, there is no sound basis for the Pilot's requirement that the consumer forfeit or otherwise return the device to the ETC.[148] Such a proposal would unreasonably deprive the Lifeline Broadband household of its investment in the device and would benefit the ETC, which has already been compensated for the full cost of the device. This provision of the Pilot must be eliminated.

NASUCA also recommends that the certification and verification process for Lifeline and Link-Up consumers be clarified. As proposed, the Pilot would make Lifeline and Link-Up Broadband support available to a smaller pool of consumers than are eligible for Lifeline and Link-Up voice support. All consumers would have to satisfy the income or program-based participation eligibility criteria established under Section 54.409 "Consumer Qualification for Lifeline."[149] However, the Pilot states that "Lifeline consumers who currently have a broadband connection and related Internet device are excluded from participation in the Pilot."[150] Specifically,

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[143] Id., ¶ 81. Those speeds are download speeds of 768 kbps and upload streams greater than 200 kbps. Id., ¶ 84.

[144] Id., n.196.

[145] Id., ¶ 90.

[146] Id.

[147] NASUCA is concerned that the Pilot design might suggest that the ETC would be required to monitor and police how the device is used. The low-income household's privacy rights must be defined and protected as a condition of the Pilot. Consumers should not be subject to lesser privacy expectations in their use of broadband Internet access as a condition of receipt of Lifeline and Link-Up Broadband support.

[148] Id.

[149] 47 C.F.R. § 54.409.

[150] Chairman's Draft Proposal, ¶ 86.

"consumers must demonstrate that they do not currently have a broadband Internet access service subscription or broadband Internet access device."[151] NASUCA is concerned by this limitation. First, consumers may be confused over just what constitutes a "broadband Internet access device," such that the device should disqualify the household from participation in the Pilot. There are an abundance of game devices and cell phones that have the capability of connecting to the Internet, but if the household does not have a broadband Internet access subscription, this feature of a device serves no purpose. If the goal of the Pilot is to increase broadband Internet access subscriptions, low income households that meet the Section 54.409 Lifeline Eligibility standards should be able to participate, even if some member of the household already has a device that is capable of connecting to the Internet. This restriction on a consumer's qualifications for the Pilot should be eliminated. The consumer should be able to self-certify that the household does not have a broadband Internet access subscription as the only additional requirement to be eligible to participate in the Pilot.

Second, the Pilot's directive that the monthly Lifeline Broadband support provided to participating customers "is separate from and in addition to their monthly Lifeline support for voice telephone service"[152] must extend to the certification and verification process of Section 54.410.[153] If a consumer receives both Lifeline voice and Lifeline Broadband support, any question or challenge to the consumer's continued eligibility for the Lifeline Broadband support should not prevent the consumer from continuing to receive Lifeline voice support, if the consumer still meets one of Section 54.409 eligibility criterion. The same process may apply for certifying and verifying eligibility for Lifeline Broadband as for Lifeline voice, but NASUCA cautions that it should not become "all or nothing," such that participation in the Pilot puts the consumer's Lifeline voice support at risk.

D. SUMMARY ON LIFELINE BROADBAND

NASUCA recommends that the Pilot be revised in accord with these comments to assure that universal service gains under the Lifeline and Link-Up support for voice service are not harmed. Although the Pilot's proposed use of the existing Lifeline and Link-Up regulatory framework is a good start, NASUCA has identified a number of areas where clarification and revisions are needed to better identify where the Pilot services will be available, to confirm the jurisdiction of states and the Commission to regulate participating ETCs, and to establish consumer protections including privacy protections specific to the Pilot and offering of Federal USF support for broadband Internet access service.

VIII. THE COMMISSION SHOULD NOT PERMANENTLY CAP THE ENTIRE HIGH-COST FUND.

In comments on the Joint Board's proposal to impose a cap on CETC USF payments, NASUCA also noted that, pending comprehensive reform, the Commission could impose a cap on the entire high-cost fund: "If … the Commission insists on maintaining competitive neutrality, then the cap could be applied to the entire high-cost fund. NASUCA proposed such a cap in an April

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151 Id.

152 Id., ¶ 78.

153 47 C.F.R. § 54.410.

6, 2007 ex parte letter. The cap would work just like the CETC cap, but would also cover incumbent LEC ETCs."[154]

Yet the Chairman's Draft Proposal would cap the high-cost fund on an apparently permanent basis.[155] NASUCA submits that such a cap is unnecessary under the circumstances. Admittedly, a cap will help ensure that the USF is no more than sufficient,[156] but will not ensure that the fund is sufficient enough. A cap on the USF will also bar additional funding for broadband service or mobility service, as recommended in the *Comprehensive Reform Recommended Decision*.[157] Thus if a cap is imposed on the high-cost fund, it should explicitly be limited to the current elements of the fund, and should explicitly recognize that other elements might need to be adopted in the future.

IX. THE COMMISSION SHOULD ELIMINATE THE IDENTICAL SUPPORT RULE.

Of the many items in the Chairman's Draft Proposal, one that NASUCA strongly supports is the affirmation of the "tentative conclusion in the *Identical Support NPRM* that competitive ETCs should receive high-cost support based on their own costs."[158] NASUCA's previous comments on the *Identical Support NPRM* demonstrate this strong support.[159]

A few of the bedeviling details deserve comment, however. First, the Chairman's Draft Proposal states,

> If no competitive ETC elects to show its own costs in a particular study area, we will conduct a reverse auction to award support to a broadband mobility provider. The reserve price for such auction shall be the largest amount of high-cost support received by a competitive ETC in the study area in 2008.[160]

This statement apparently assumes a number of things, including: 1) that the only purpose for a CETC is to provide broadband mobility; 2) that there is a CETC in the area receiving support, to use as a reserve price; and 3) that, without support, there will be no mobile service.[161] None of these assumptions is safe to make.

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[154] 05-337, 96-45, NASUCA Comments Supporting a Cap on the High-Cost Universal Service Fund (July 6, 2007) at 11-12 .

[155] Chairman's Draft Proposal, ¶ 14.

[156] Id., ¶¶ 14-15.

[157] The Chairman's Draft Proposal provides no basis for assuming that the level of funding as of December 2008 (id., ¶ 16) is the appropriate level at which to cap the high-cost fund.

[158] Id., ¶ 53, citing 23 FCC Rcd at 1470, ¶ 5.

[159] 05-337, 96-45, NASUCA Comments on the Identical Support Rule (April 17, 2008); id., NASUCA Combined Reply Comments (June 2, 2008) at 33-36.

[160] Chairman's Draft Proposal, ¶ 56.

[161] In a June 13, 2007 ex parte filing by Criterion Economics, LLC ("Criterion"), based on a detailed regression analysis, Criterion found "no statistically significant relationship between subsidies and either the availability of wireless service or the number of carriers offering service." 05-337, Criterion ex parte (June 13, 2007) at 3. Likewise, Criterion found that the USF dollars that go to CETCs "do not promote lower prices in high costs areas [sic], and their effect on availability is at best indirect and highly attenuated." Id.

It does appear, however, that the concept embodied in the Comprehensive Reform Recommended Decision of separate broadband and mobility funds, focused on unserved areas, is a better way to address these issues than the approach proposed by the Chairman. That being said, on the identical support rule, NASUCA reiterates its longstanding position that CETC support should be capped at the level of support granted the incumbent. Otherwise, we will be subsidizing competition, which is unnecessary and illogical.

X. THE COMMISSION SHOULD NOT ADOPT A NUMBERS-BASED USF CONTRIBUTION MECHANISM FOR RESIDENTIAL CUSTOMERS.

The Chairman's Draft Proposal states, "The system of contributions to the universal service fund is broken."[162] This claim has been made for years. It is no more true now than when first made. NASUCA has continually presented the data to the Commission to show that the current revenues-based mechanism is not in a "death spiral,'[163] and that the "patches" to the system adopted by the Commission[164] are actually necessary adjustments to reflect changes in technology and patterns of use. This data includes the recent indications that, *ceteris paribus*, the assessment factor for the first quarter of 2009 will be at its lowest point in years.[165]

There is certainly no need for a massive overhaul such as proposed by the Chairman.[166] Notably, the Chairman's Draft Proposal does not even mention the costs of transitioning to the new mechanism, another issue consistently raised by NASUCA that has never been responded to by the industry.

The Alternative Proposal correctly points out that "Section 254(d) of the Act requires 'every carrier' that provides interstate telecommunications services to contribute to the universal service fund."[167] There are interexchange carriers that do not provide numbers. They will be exempt from a numbers-based mechanism.

The Chairman's Draft Proposal does present some new aspects that make the numbers-based mechanism actually more problematic than the proposals made by AT&T and Verizon.[168] First, the Chairman's Draft Proposal limits the numbers-based mechanism to residential customers, leaving non-residential customers with the current revenues-based mechanism (subject to future changes in another NPRM).[169] Even AT&T and Verizon opposed such a hybrid system.[170] This

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162 Chairman's Draft Proposal, ¶ 97.

163 Most recently in the NASUCA September 30, 2008 ex parte (at 7 and Attachment).

164 Chairman's Proposed Decision, ¶ 97.

165 Universal Service Administrative Company filing (October 31, 2008).

166 In the Chairman's Proposed Decision, the assertion is made that all IP-to-PSTN traffic and all PSTN-to-IP traffic represents information services and is thus within the Commission's exclusive jurisdiction. One might think that this would mean that all such traffic is therefore assessable for the interstate universal service fund. But that is not exactly consistent with the FCC's argument in the Eight Circuit that Kansas was within its rights to assess VoIP traffic for its intrastate USF.

167 Appendix B, ¶ 78.

168 See AT&T/Verizon ex parte filing (September 11, 2008).

169 Chairman's Draft Proposal, ¶ 92.

170 06-122, et al., AT&T/Verizon ex parte (October 20, 2008) at 1.

proposal ignores the fact that most of the issues alleged to be threatening the current mechanism are more, not less, prevalent on the business side than for residential service.

Second, the Chairman's Draft Proposal "set[s] the per-number [residential] assessment at the fixed rate of $1.00 per month."[171] Despite the claims that that number is supported in the record,[172] the $1 number is arbitrary, as opposed to the current revenue-based assessment figure, which is calculated by dividing the actual needs of the USF by the total assessable revenues, and applies equally to residential and to business customers.[173] And the value of a "simple and predictable" assessment for residential customers[174] is vastly overstated; it obviously depends more on the level of the assessment rather than on the fact that the assessment will not change quarter-to-quarter.

But the needs of the USF change quarter-to-quarter.[175] This means that a fixed residential assessment -- assuming a steady level of residential numbers -- makes the non-residential contribution a residual, subject to the vagaries of the overall needs of the fund. This would be true for a revenues-based legacy system, and would also be true for a connections-based non-residential system (unless that were also set at a fixed amount, which would leave changes in funding needs to be addressed in some unknown fashion).[176]

Finally, we should note that one of the supposed benefits of a numbers-based mechanism -- that it will promote number conservation[177] -- is undercut by the proposed structure of the proposal. In the Chairman's Draft Proposal, the assessment would not be based on assigned numbers[178]; it is instead based on a new, much more limited definition of "assessable numbers."[179] Area code exhaust is primarily driven by assigned numbers, not the subset assessed by the Chairman's Draft Proposal. This is particularly true for residential customers. Indeed, there does not appear to be any basis for assuming that residential number usage is a major cause of area code exhaustion.

That being said, we do appreciate that the Chairman's Draft Proposal has strictly limited the exemptions from number-based assessment, to Lifeline service[180] and free Community Voice Mail ("CVM").[181] Lifeline customers should be exempt just as they are currently exempt from paying USF assessments on the SLC.[182] NASUCA has supported exempting CVM[183]; the

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[171] Chairman's Draft Proposal, ¶ 92.

[172] Id., n.271.

[173] Similarly, the per-connection rates under the Narrow Proposal (Narrow Proposal, ¶ 81) are arbitrary.

[174] Id., ¶ 107.

[175] Even though the Chairman's Draft Proposal seeks to cap the high-cost portion of the USF (id., ¶ 14), the high-cost fund is only one of the four components of the USF.

[176] See Narrow Proposal, ¶ 82.

[177] Id., ¶ 111.

[178] Id.

[179] Id., ¶¶ 116-124.

[180] Id., ¶¶ 141.

[181] Id., ¶ 142.

[182] Clearly, under the current mechanism, Lifeline customers could also be made exempt from other USF assessments on their Lifeline-designated lines. Thus the exemption of Lifeline

(continued….)

Chairman's Draft Proposal accurately expresses the reasons for doing so.[184] Other of the claims for exemption may also have merit, but the more exemptions or discounts are granted, the more complicated the calculation for other customers grows.[185]

XI. CONCLUSION

Given the many gaps in the Chairman's Draft Proposal, it is almost astounding that it was presented as something the Commission could vote on and might have approved, had it not been for the tremendous public outcry and the correct choices by the other Commissioners. At this point, however, summary rejection of all three of the proposals attached to the FNPRM would be appropriate. The only parts that could be adopted at this point are the proposals on phantom traffic and the identical support rule.

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customers from the numbers-based assessment cannot be cannot be seen as a unique benefit of the Chairman's Draft Proposal on USF assessments.

[183] See, e.g., 06-122 et al., NASUCA Comments to Refresh the Record (July 7, 2008), n.78.

[184] Chairman's Draft Proposal, ¶ 142.

[185] Apparently under the Chairman's Draft Proposal, the burden of picking up lost collections from exempted services would fall only on business customers.

APPENDIX

SUPPORT RECEIVED BY NON-RURAL ILECS

State	Non-rural carrier(s)	2007 HCM support ($ millions)	2007 IAS/ICL support ($ millions)	2007 total support ($ millions)[186]	2005 total support ($ millions)	Total 2007 support / loop / month
Alabama	South Central Bell[187]	24.1	9.9	34.0	35.1	$1.65
	CenturyTel (Southern)	4.7	3.3	8.0	9.4	$4.64
	CenturyTel (Northern)	8.3	2.0	10.3	10.7	$7.25
Alaska	ACS of Anchorage	0	4.3	4.3	4.6	$2.69
Arizona	Qwest	0	12.3	12.3	12.7	$0.46
Arkansas	Southwestern Bell	0	1.0	1.0	5.5	$0.06
California	Verizon (Contel)	0	5.7	5.7	5.9	$1.17
	Verizon (GTE)	0	18.1	18.1	18.9	$0.39
	SureWest	0	2.0	2.0	3.7	$1.34
	Pacific Bell	0	8.6	8.6	0	$0.04
Colorado	Qwest	0	19.2	19.2	20.2	0.69
Connecticut	SNET	0	1.0	1.0	0.5	0.02
DC	Verizon	0	0	0	0	0
Delaware	Verizon	0	0.3	0.3	0.3	0.04
Florida	Verizon	0	18.3	18.3	28.1	0.77
	Southern Bell	0	10.2	10.2	10.2	0.15
Georgia	Southern Bell	0	17.4	17.4	15.8	0.41
Hawaii	Verizon	0	2.2	2.2	6.8	0.29
Idaho	Qwest	0	0	0	0	0
Iowa	Qwest	0	0.5	0.5	0.6	0.04

[186] Totals may not be exact due to rounding.
[187] ILEC names in this table are as they were in 2005. Principal changes would be to include as AT&T all the companies now under that banner.

State	Non-rural carrier(s)	2007 HCM support ($ millions)	2007 IAS/ICL support ($ millions)	2007 total support ($ millions)	2005 total support ($ millions)	Total 2007 support / loop / month
Illinois	Verizon	0	6.2	6.2	6.8	0.89
	Verizon (Contel)	0	3.4	3.4	3.9	2.40
	Illinois Bell	0	0	0	0	0
Indiana	Verizon	0	14.2	14.2	15.7	1.71
	Verizon (Contel)	0	5.0	5.0	5.3	2.24
	Indiana Bell	0	0	0	0	0
Kansas	Southwestern Bell	0	0.5	0.5	9.6	0.04
Kentucky	Cincinnati Bell	0.7	0.2	0.9	1.0	0.42
	South Central Bell	9.1	6.6	15.7	17.2	1.27
	ALLTEL	3.9	5.5	9.4	14.7	2.01
Louisiana	South Central Bell	0	8.9	8.9	9.6	0.41
Maine	Verizon	1.6	0.1	1.7	2.1	0.23
Massachusetts	Verizon	0	1.8	1.8	1.9	0.04
Maryland	Verizon	0	2.6	2.6	2.3	0.06
Michigan	Verizon	0	0.5	0.5	0.4	0.06
	Michigan Bell	0	0	0	0	0
Minnesota	Qwest	0	0	0	0	0
Mississippi	South Central Bell	86.0	14.8	99.8	113.7	7.19
Missouri	Southwestern Bell	0	0	0	3.5	0
	CenturyTel (Central)	0	0.8	0.8	0.8	0.79
	CenturyTel (Southwest)	0	2.6	2.6	2.9	1.04
Montana	Qwest	14.5	0.4	14.9	16.7	3.96
Nebraska	ALLTEL[188]	2.6	0	2.6	3.9	0.85
	Qwest	2.3	3.0	5.3	5.8	1.30
North Carolina	Verizon	0	4.2	4.2	7.5	2.07
	North State	0	2.8	2.8	4.9	1.98
	Verizon (Contel)	0	5.0	5.0	5.0	2.95
	Southern Bell	0	4.6	4.6	10.0	0.18
North Dakota	Qwest	0	0.5	0.5	0.5	0.25

[188] ALLTEL in Nebraska is the only carrier to receive only HCM support and no access support.

State	Non-rural carrier(s)	2007 HCM support ($ millions)	2007 IAS/ICL support ($ millions)	2007 total support ($ millions)	2005 total support ($ millions)	Total 2007 support / loop / month
Nevada	Central	0	1.6	1.6	1.5	0.17
	Nevada Bell	0	4.0	4.0	3.0	0.92
New Hampshire	Verizon	0	1.8	1.8	1.9	0.22
New Jersey	Verizon	0	0	0	0	0
New Mexico	Qwest	0	4.4	4.4	4.2	0.47
New York	Verizon	0	7.2	7.2	8.4	0.07
	Frontier Rochester	0	0	0	0	0
Ohio	Verizon	0	7.2	7.2	8.1	0.72
	Cincinnati Bell	0	0	0	0	0
	Ohio Bell	0	0	0	0	0
Oklahoma	Southwestern Bell	0	0.9	0.9	3.8	0.06
Oregon	Verizon	0	10.4	10.4	13.9	2.13
	Qwest	0	2.6	2.6	2.6	0.18
Pennsylvania	Verizon North	0	3.4	3.4	3.4	0.55
	Verizon	0	9.0	9.0	0	0.15
Puerto Rico	PRTC Central	0	9.1	9.1	9.0	4.71
	PRTC	0	49.0	49.0	58.2	4.10
Rhode Island	Verizon	0	.035	.035	0.06	0.01
South Carolina	Verizon	0	4.9	4.9	6.0	2.69
	Southern Bell	0	4.9	4.9	5.2	0.32
South Dakota	Qwest	1.5	.009	1.5	1.6	0.67
Tennessee	South Central Bell	0	6.8	6.8	7.3	0.25
Texas	GTE	0	18.7	18.7	19.2	1.16
	Contel	0	3.3	3.3	3.3	2.52
	Southwestern Bell	0	0.09	0.09	0	0
Utah	Qwest	0	1.2	1.2	1.1	0.11
Vermont	Verizon	7.7	2.0	9.7	10.3	2.43
Virginia	Contel	0	26.8	26.8	38.2	3.83
	Verizon	0	10.9	10.9	11.6	0.30
Washington	Verizon	0	4.6	4.6	15.9	0.56
	Contel	0	2.1	2.1	4.9	2.00
	Qwest	0	2.6	2.6	0	0.10
West Virginia	Verizon	21.9	7.6	29.5	30.6	3.14

State	Non-rural carrier(s)	2007 HCM support ($ millions)	2007 IAS/ICL support ($ millions)	2007 total support ($ millions)	2005 total support ($ millions)	Total 2007 support / loop / month
Wisconsin	Verizon	0	0	0	0	0
	Wisconsin Bell	0	0	0	0	0
Wyoming	Qwest	8.8	3.9	12.7	14.6	4.74